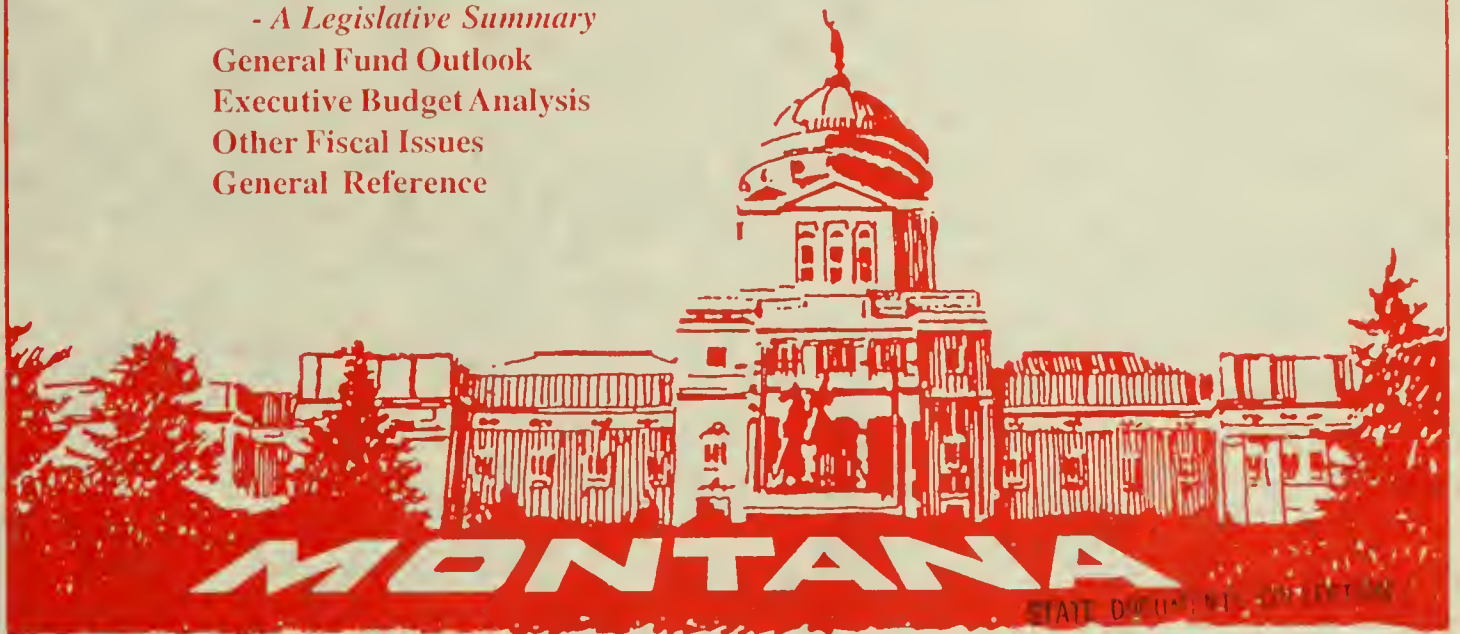


LEGISLATIVE BUDGET ANALYSIS 2007 BIENNIUM

Volume 1 - Statewide Perspectives

State Budget Outlook
- *A Legislative Summary*
General Fund Outlook
Executive Budget Analysis
Other Fiscal Issues
General Reference



January 2005

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LEGISLATIVE BUDGET ANALYSIS

2007 Biennium

Volume 1 – Statewide Perspectives

Presented to the Fifty-ninth Legislature

Submitted by

The Legislative Fiscal Division

Helena, Montana

January 2005



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MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building * P.O. Box 201711 * Helena, MT 59620-1711 * (406) 444-2986 * FAX (406) 444-3036

Legislative Fiscal Analyst
CLAYTON SCHENCK

December 2004

Members of the Fifty-ninth Legislature:

I submit for your consideration a fiscal analysis of the state budget outlook for the 2007 biennium and Governor Martz's Executive Budget. It is our goal that this analysis will provide the information and insight necessary for legislators to craft an effective state budget and fiscal policy for the 2007 biennium. This four-volume report includes:

- Volume 1: Statewide Perspectives – This volume provides a summary overview of the state fiscal outlook and the executive budget analysis as well as a general reference section
- Volume 2: Revenue Estimates – This volume provides the revenue estimates and underlying economic assumptions included in the revenue estimate resolution (HJR 2), and is designed as a working document for the taxation committees
- Volumes 3 and 4 – These volumes are designed to serve as working documents for the appropriations subcommittees. They provide:
 - The Governor's agency budget recommendations
 - The Legislative Fiscal Division's detailed descriptions and analysis of the various components of the Executive Budget

Our analysis will be updated in January to reflect any budget revisions submitted by Governor-elect Schweitzer.

Your staff of the Legislative Fiscal Division look forward to being of service to the legislature during the 2003 session. We welcome any opportunity to assist you in obtaining the best possible fiscal information to facilitate setting fiscal policy. Staff names, assignments, and phone extensions are listed on page xiii. Please feel free to call on us!

Respectfully submitted,

A handwritten signature in cursive script that reads "Clayton Schenck".

Clayton Schenck

Legislative Fiscal Analyst

This analysis was created
In accordance with Section 5-12-302, MCA
by the Legislative Fiscal Division.

Special thanks to Director Chuck Swysgood and the
Office of Budget and Program Planning, as well as
agency directors and budget personnel
for their gracious cooperation
in this budget analysis effort.

I am deeply indebted to an exceptional LFD Staff
for their thousands of extra hours
and personal sacrifice in preparing this analysis.
Their dedication and professionalism
are a credit to the Legislature and the citizens of Montana.

Thanks also to
Leona Olsen and staff
of the Publications and Graphics Bureau
for exceptional customer service
in publishing this report.

Questions and comments regarding this report
should be directed to:
Clayton Schenck, Legislative Fiscal Analyst
(406) 444-2986
cschenck@state.mt.us

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Cathy Duncan
Marilyn Daumiller
Harry Freebourn
Barbara Smith
Alan Peura
Shane Sierer
Diane McDuffie
Cassie Rice-Wetzel

Legislative Fiscal Analyst
Principal Fiscal Analyst
Principal Fiscal Analyst
Fiscal Specialist
Information Technology
Senior Fiscal Analyst
Senior Fiscal Analyst
Senior Fiscal Analyst
Senior Fiscal Analyst
Senior Fiscal Analyst
Senior Fiscal Analyst
Associate Fiscal Analyst
Associate Fiscal Analyst
Associate Fiscal Analyst
Associate Fiscal Analyst
Associate Fiscal Analyst
Office Manager
Administrative Support

HOW TO USE THIS REPORT

The *Legislative Budget Analysis, 2007 Biennium* is published in four volumes. The report is designed to assist the 2005 legislature in setting fiscal priorities and to help legislators reflect those priorities in the 2007 biennium General Appropriations Act (HB 2).

Volume 1

Volume 1, which includes a legislative summary, provides an overview of the proposed budget. *Volume 1* also summarizes significant fiscal issues that may impact more than one agency or that do not fall under the jurisdiction of a single appropriation subcommittee. Generally, this volume attempts to answer the following questions:

- What is the state's fiscal condition?
- What are the major fiscal challenges facing the 2005 legislature?
- What are the key features of the executive budget?
- What other fiscal issues are important to consider?

The "State Budget Outlook" section on pages 1 through 27 provides a high level summary of the material presented in *Legislative Budget Analysis*.

This volume is structured to present a general fund outlook for the 2005 biennium and 2007 biennium, an analysis of the *Governor's Executive Budget* proposals, including issues identified by the LFD analysis, and a discussion of other fiscal issues that are related to the budget deliberations. The reference section, at the end of *Volume 1*, presents a range of budget-related material. This section is considered especially useful for new legislators and those who have not previously had direct involvement in the appropriations process.

An index in the back of *Volume 1* is the most comprehensive for the purpose of searching for information in all four volumes.

Volume 2

Volume 2 includes a summary and overview of the state's major revenue sources. A review of the table of contents will give the reader a quick idea of revenue sources included and the structure of the report. This volume will be provided to the House and Senate Taxation committees for use as a working document, and delineates the economic assumptions used to derive revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC) and introduced in the revenue estimate bill (HJR 2).

Volumes 3 and 4

Volumes 3 and 4 offer detailed analyses of individual agency budgets, as proposed through the Governor's Executive Budget submitted in mid-November. These volumes feature program-by-program detail, as well as the LFD analysis of each agency budget. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

Volume 3:

A – General Government and Transportation

B – Health and Human Services

Volume 4:

C – Natural Resources and Commerce

D – Corrections and Public Safety

E – Education

F – Long-range Planning

A specific agency can be located in any of three ways. The general index included in each volume provides an alphabetical listing of agencies and other topics, in conjunction with appropriate volume and page numbers. If the subcommittee addressing a given agency is known, the cover page of each section lists agencies, in order by appearance. Agency names are also visible on page headings within their respective sections.

Volumes 3 and 4 briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the analysis is consistent across agencies. These volumes detail an agency's requests, as well as a list of proposals and issues significant to the agency. When appropriate, there may be discussion of circumstances that could hold budgetary impacts (e.g., proposed executive legislation or agency reorganization). These volumes also present detailed discussions of present law adjustments, new proposals, and significant issues facing the various agencies as identified by legislative fiscal analysts.

Agency budgets are presented in three tiers as required by statute:

1. **Base budget:** the level of funding authorized by the previous legislature;
2. **Present law base:** the additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature; and
3. **New proposals:** requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, legislators can use the "base budget" as the starting point, then to follow the incremental increases that result in a total budget request for an agency.

Proprietary Rate Setting

HB 576 (1995) removed the requirement that proprietary – or internal service and enterprise – funds be appropriated by the legislature. Instead, the legislature approves the rates charged for those particular services and products. HB 576 also requires the Office of Budget and Program Planning to submit a report as part of the Executive Budget. This report includes fees and charges, projected fund balances, retained earnings, and contributed capital for providers. Although the legislature does not appropriate funds for the operation of these programs, it does approve the rates charged. These reports and the LFD analysis of the reports are included in the agency presentations in Volumes 3 and 4, as appropriate.

LEGISLATIVE FISCAL DIVISION (LFD)
State Capitol, First Floor, East Wing, Telephone 444-2986
STAFF ASSIGNMENTS

General Government & Transportation

Greg Dewitt (44-5392, Office #119)
Secretary of State
Transportation
Revenue
Administration
Appellate Defender Commission
Montana Consensus Council

Marilyn Daumiller (444-5386, Office #108B)
Legislative Branch
Consumer Counsel
Governor's Office
Commissioner of Political Practices
State Auditor's Office

Health & Human Services

Lois Steinbeck (444-5391, Office #118)
Pat Gervais (444-1795, Office #117)

Natural Resources & Commerce

Barbara Smith (444-5347, Office #108J)
Fish, Wildlife & Parks
Environmental Quality
Natural Resources & Conservation

Shane Sierer (444-2722, Office #108C)
Livestock
Agriculture
Commerce

Corrections & Public Safety

Harry Freebourn (444-5834, Office #108I)
Board of Crime Control
Judiciary
Justice
Public Service Regulation
Corrections

Shane Sierer (444-2722, Office #108C)
Military Affairs
Labor & Industry
Education

Education

Marilyn Daumiller (444-5386, Office #110A)
School for the Deaf and Blind
Board of Public Education
Montana Arts Council
Library Commission
Montana Historical Society

Education (cont.)

Alan Peura (444-5387, Office 108D)
Commissioner of Higher Education/Board of Regents
Community Colleges
Six University Units and College of Tech.
Agricultural Experiment Station
Extension Service
Forestry & Conservation Experiment Station
Bureau of Mines & Geology
Fire Services Training School

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Office of Public Instruction

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Long-Range Building
State Building Energy Conservation
Treasure State Endowment
Treasurer State Endowment Regional Water
Renewable Resource Grant & Loan Program
Reclamation & Development Grant Program
Cultural and Aesthetic Grant Program

Revenue Estimating/Monitoring/Tax Policy

Terry Johnson (444-2952, Office #115)
Jim Standaert (444-5389, Office #113)
Roger Lloyd (444-5385, Office #120)

Public School Funding

Jim Standaert (444-5389, Office #113)

Information Technology

Mike Allen (444-4101, Office #130)

Support Staff

Diane McDuffie (444-2986, Office #110A)
Cassie Rice-Wetzel (444-2986, Office #110A)

Fiscal Specialist

Jon Moe (444-4581, Office #132)

Principal Fiscal Analysts

Terry Johnson (444-2952, Office #115) – Revenue
Taryn Purdy (444-5383, Office #114) - Budget

Legislative Fiscal Analyst & Director

Clayton Schenck, (444-2988, Office #116)

STATE BUDGET OUTLOOK

A Legislative Summary

Introduction

Economic Overview

State Fiscal Picture

Major Fiscal Challenges/Solutions/Issues

Executive Budget Highlights

Other Fiscal Issues





INTRODUCTION

After facing a period of severe revenue shortfalls, Montana is seeing a dramatic turnaround in some key revenue sources. Revenues from individual income and oil and gas taxes have increased significantly in 2004. Rather than beginning the 2005 session with a large deficit, as was the case in 2003, the legislature will start with a large projected fund balance as of the end of FY 2005. But the surplus is not necessarily what it appears to be, as a significant portion is from one-time, nonrecurring revenue. That means there is some risk in using these revenues for ongoing programs or services. In what is always a challenging fiscal environment, the 59th Legislature will be faced with an opportunity to shape a budget that addresses some of the state's ongoing fiscal issues while at the same time taking on some very daunting emerging fiscal challenges, including the school funding lawsuit.

In this first chapter, we provide an executive summary of the state budget outlook. It includes a state economic overview, how those economic conditions affect the state fiscal outlook and the general fund budget in particular, and the projected general fund outlook. We then summarize the major fiscal challenges this legislature faces, the executive response/solutions to the challenges, as well as issues regarding those challenges/solutions. We also present summary highlights of the executive budget and the executive budget priorities. Other significant fiscal issues facing this session are also highlighted.

In a nutshell, this section provides summary answers to the following questions:

- What is the current economic profile of Montana?
- What is the state's fiscal condition?
- What is the projected general fund outlook?
- What are the major fiscal challenges facing the 2005 Legislature?
- What are the executive solutions?
- What are the significant issues identified by the LFD analysis?
- What are the key features and priorities of the executive budget?
- What other fiscal issues are important to consider?

The majority of the issues discussed in this overview are discussed in more detail in the remaining chapters.



ECONOMIC OVERVIEW

Montana state government, like any other business, is influenced by economic and demographic developments. For example, Montana's economic base as well as the strength of the U.S. economy determines the level of revenues collected from personal and corporate income taxes, property taxes, natural resource taxes, and investment earnings. Similarly, both economic and demographic variables affect state government disbursements for education, human services, corrections, and other governmental services.

Montana's total revenue base is comprised of a number of taxes and fees plus numerous federal reimbursements or grants. Revenues are further enhanced from the investment of trust monies and idle cash pending disbursement from the state treasury. Since individual income tax is the state's largest general fund tax source, economic developments or trends in the areas of employment and income levels significantly influence available revenues to fund governmental services. Federal revenue correspondingly is used to fund a number of human service, transportation, and educational services. In a number of instances, general or state special revenue fund dollars are required to provide a state match before the federal funds can be disbursed.

Conversely, Montana's total expenditure base is targeted toward educational and human service programs, with a significant allocation to highway construction. Education and human service costs are driven by some of the same economic and demographic conditions that influence state revenues. If employment levels increase, this usually translates to an increase in population or a reduction in unemployment levels. With population increases comes a corresponding increase in educational and human service costs. A greater population requires a better transportation system, not only for the general populace, but also for the businesses that expect to expand to meet the needs of an ever-growing population.

Montana's economy is highly dependent on agriculture, tourism, natural resource extraction, and mining. All of these industries produce residual wholesale/retail trade and service sector jobs. If the basic industries are not flourishing, other sectors suffer as well. And if Montana's economy slows, tax revenue growth usually follows the trend because of the state's dependence on income tax revenues.

In some instances, economic strength can be a "good news / bad news" dilemma. For example, if total personal income increases significantly, this usually translates into higher individual income taxes. On the disbursement side, however, strong personal income growth can result in increased state general fund match amounts for the federal Medicaid program. If Montana's total personal income growth is unusually high when compared to the national average, the federal medical assistance percentage (FMAP) rate declines, thereby requiring the state's matching rate to increase. This situation is expected to occur during the 2007 biennium.

Employment and wage indicators continue to support stronger growth in the near-term, with the prospect of more average growth from calendar 2005 to 2007. While capital gains income rebounded in calendar 2003, net capital gain realizations are expected to increase only modestly during calendar 2005, 2006, and 2007.

During calendar 2001, the Federal Reserve Board (FRB) reduced interest rates 12 times in an attempt to stimulate the US economy. As the economy began to regain strength in calendar 2004, the FRB began increasing rates to insure stable growth with the goal of maintaining low inflation. Most economists project interest rates to increase through the 2007 biennium but to levels below historical averages. Short-term rates are not expected to exceed four percent, while long-term rates are expected to be close to six percent. The effects of higher interest rates may have some dampening impacts on economic growth to the benefit of increased state revenues from investments.

Even though interest rates have increased from historic lows, corporate profits are expected to increase significantly during calendar 2005 and increase modestly thereafter. Property values resumed an upward trend in 2003, and that trend is expected to continue through the 2007 biennium. Net taxable value growth in tax year 2006, however, is expected to be near 10 percent as several tax increment financing districts are eliminated.

After decades of reductions in oil production – from a peak in 1973 of 34 million barrels to a trough in 1999 of 15 million barrels – recent Montana production has increased. With higher prices, new drilling activity increased 75 percent in 2003, and has increased nearly the same amount in 2004. In calendar 2003, production was over 19 million barrels and will probably be near 22 million barrels in calendar 2004. Higher production is expected to continue.

Natural gas production in Montana doubled between 1981 and 2003 due to higher market prices, from 40 million MCF to 80 million MCF, with 75 percent of that increase since 1997. Newly drilled wells have contributed about 20 percent to total production since calendar 2000. As with the oil market, new drilling activity was up substantially in calendar 2003 and 2004. Higher production is expected to continue into the next biennium.

In summary, the economic outlook for the state is for moderate growth throughout the forecast period. This general premise of moderate growth is supported by testimony received on November 16, 2004. The Revenue and Transportation Interim Committee set aside part of a scheduled meeting to hear from Dr. Paul Polzin, Bureau of Business and Economic Research, and Dr. Myles Watts, Department of Agricultural Economics, Montana State University. Each of these economic experts provided the committee with their outlook on various aspects of the state and national economies.

What is the state's fiscal condition?

What is the state's projected budget outlook?



STATE FISCAL PICTURE

STATE FISCAL OUTLOOK

The previous section described the economic outlook for Montana from the perspective of how economic activity at both the state and national level impacts state revenues and expenditures. This section describes in more detail how those economic conditions determine the state fiscal outlook and ultimately the size of the 2007 biennium budget.

GENERAL FUND REVENUE IMPLICATIONS

Montana's fiscal outlook for revenue growth is significantly more optimistic than the last biennium. The preliminary revenue estimates adopted by the Revenue and Transportation Interim Committee (HJR2) are based on moderate economic growth through calendar 2007, with slightly stronger growth for calendar 2006 at both the national and state levels. Figure 1 shows the comparative change by major revenue category, for an average increase of 4.8 percent over the 2005 biennium. For a complete discussion of general fund revenue projections by category, see the detailed explanation for each revenue component in Volume 2, "Revenue Estimates".

Figure 1

General Fund Revenue By Major Category			
Major Category	2005 Biennium	2007 Biennium	Percent Change
	Estimate Millions	Estimate Millions	
Individual Income Tax	1,193.986	1,234.869	3.42%
Corporation Income Tax	134.055	158.548	18.27%
Vehicle Tax	163.967	162.190	-1.08%
Investment Earnings	87.901	100.336	14.15%
Natural Resource Taxes	124.993	145.916	16.74%
Property Tax & Non Levy	339.582	358.486	5.57%
Insurance Tax	115.805	127.383	10.00%
Consumption Tax	240.558	247.732	2.98%
All Other Revenue	365.357	362.856	-0.68%
Total General Fund	2,766.204	2,898.316	4.78%

The key economic assumptions targeted as most affecting state government receipts are Montana total income (all sources reported as individual income tax income), employment and population levels, inflation rates, corporate profits, property values, interest rates, and energy prices. As discussed in the previous section, "Economic Overview", the outlook for the majority of these targeted assumptions is positive for Montana's economy. The impacts of the current economic situation are reflected in the assumptions that were used to derive the revenue estimates and key factors are briefly highlighted below. A detailed explanation for each revenue component is in Volume 2, "Revenue Estimates".

- Wage and salary income provides the largest portion of Montana total income. On average, wage and salary income contributes over 65 percent of total income. Average growth has been 5.5 percent from calendar 1990 to 2003. For calendar 2005, growth is expected to be 4.4 percent, and 4.5 percent in calendar years 2006 and 2007.
- Capital gains income increased sharply in relative importance during the 1990s, growing from 4.2 percent to 9.2 percent of total income. In 2001, capital gains income dropped by nearly 38 percent over 2000, to 5.7 percent. Capital gains is projected to increase by 11.1 percent between 2004 and 2007, a compound growth rate of 2.7 percent annually.

- Average annual growth in employment between 1990 and 2003 has been 2.1 percent, although since 2000 the average rate of growth has been 1.1 percent. It is expected that employment growth through 2005 will remain at 1.2 percent and grow by 1.3 percent in calendar years 2006 and 2007.
- Population growth since the early 1990s has been positive, varying between 0.1 percent in 1998 to 2.3 percent in 2000. Growth through the next biennium is estimated at 0.4 percent annually. This factor impacts any consumption taxes and overall profitability.
- Since 1990, inflation has averaged 2.7 percent annually, and is estimated at 2.2 percent through the next biennium.
- Between 1990 and 1997, U.S. corporation tax profits increased an average 9.9 percent per year, but have decreased an average 2.7 percent annually from 1998 through 2001. In 2002 and 2003, corporate profitability increased by 7.1 percent and 15.4 percent respectively, and that trend is expected to continue, with projected annual increases of 13.5 percent, 34.8 percent, 1.5 percent, and 3.6 percent between 2004 and 2007.
- Property tax values increased slowly in the 1990s but fell in fiscal 2000 and 2001, primarily due to legislative tax changes. Property values resumed an upward trend in 2003, and that trend is expected to continue through the next biennium. However, net taxable value growth in tax year 2006 is expected to be near 10 percent as several tax increment financing districts are eliminated.
- Interest rates dramatically declined beginning in January 2001 to an unprecedented low in 2004. However, as the economy regains strength, interest rates are projected to increase through the 2007 biennium.
- As discussed in the previous section, high energy prices, especially for oil and natural gas production, are expected to substantially increase Montana production. Oil and gas production was 19 million barrels in 2003, and is expected to increase to 25 million barrels in 2005, 28 million barrels in 2006, and 30 million barrels in 2007. Natural gas production was 80 million MCF in 2003, and is expected to be 95.2 million MCF in 2005, 101 million MCF in 2006, and 106 million MCF in 2007.

GENERAL FUND EXPENDITURE IMPLICATIONS

Montana's expenditure growth, like revenue growth, is responsive to economic and demographic conditions. While income levels, commodity prices, and interest rates influence revenue trends significantly, expenditure trends are more susceptible to population trends and demographic characteristics. Inflation rates also significantly impact expenditure trends, but are not a good overall measure of expenditure trends.

As discussed previously, total population growth trends in recent years have abated from historical levels and are expected to grow at only 0.4 percent per year throughout the next biennium. Even with a slower growth rate, the demand for state services continues to increase. Depending on the demographics (age, income, etc.) of the population base, the demand for government services will emerge in the form of increased school enrollments, caseloads, or government employee workload. Demographics play a significant role in determining the cost of governmental services. With a shift in average age, school populations have declined while human services and corrections populations have grown. "Baby boomers" will continue to place increased pressures on government social programs as they enter retirement age.

The Martz budget, following a biennium that saw reductions in state services to balance the budget, reflects a steep demand for government services due to caseload and service user population increases. The executive requests a \$210 million general fund increase over the FY 2004 base just to continue existing state services. The highest increases are in human services, education, and corrections, which represents nearly 87 percent of all general fund spending. In total, the executive budget requests a \$312 million (11 percent) increase in general fund over the FY 2004 base.

GENERAL FUND ECONOMIC IMPLICATIONS – SUMMARY

In summary, revenue growth is expected to be moderate through the 2007 biennium, and when coupled with a large beginning general fund balance, the 2005 Legislature faces a nearly unprecedented surplus as it begins to prioritize state spending. Montana generally escaped the economic recession of the early 2000s, and although state revenues dropped off sharply, they are expected to slowly recover in the 2005 and 2007 biennia from the significant declines in the 2003 biennium.

The cost of governmental services will continue to increase, even with a moderate rate of inflation and a slow growth rate in total population. School enrollments are declining, yet costs to support public schools continue to increase, especially in view of the recent court decision that schools are underfunded. Human services costs will continue to escalate because of greater caseload demands, higher medical costs, and a higher state Medicaid match rate to due improved per capita incomes. Corrections population growth projections also suggest significant expenditure growth pressures.

While the legislature faces a brighter picture than two years ago, caution is in order. Income tax growth will be moderate during the transition to SB 407 (tax reform), and the full effects of the SB 407 tax cuts will not be fully felt until fiscal 2008, when the increase in the capital gains credit to 2 percent becomes effective for a full fiscal year. The bonus depreciation provisions will not add to corporation tax liabilities past the 2007 biennium. Furthermore, there is always uncertainty surrounding the price of oil and a quieting of the war in Iraq could send oil prices down sharply, slowing new drilling activity. In addition, the long-term stability of the general fund is cloudy, as discussed beginning on page 142 of this volume.

GENERAL FUND STATUS

The previous sections described the economic outlook for Montana and how those economic conditions determine the state fiscal outlook. This section looks at the specific general fund projections for the current biennium, and ultimately the size of the 2007 biennium budget, in view of the existing and forecasted economic conditions. We begin, however, with an explanation of how the state went from a record deficit in the last session to a record surplus in the 2007 biennium.

BUDGET SURPLUS: HOW WE GOT HERE

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. During calendar 2002 and 2003, however, the state's financial picture blurred as the effects of a national economic recession, terrorism threats, and mid-east tensions played havoc on the U.S. economy. Although Montana's economic base remained relatively stable during this period, state general fund revenues plummeted. This inconsistency was due to the precipitous fall in equity markets, low interest rates, and reduced corporate profits. All of these factors contributed to the 2002/2003 budget crisis while the state's economy continued to outperform the national economy.

Beginning in fiscal 2004, Montana's revenue picture continued to show signs of weakness. Income tax receipts were sluggish, interest rates continued at historic low levels, and corporation income tax refunds were significant. In early calendar 2004, however, the first signs of an improving revenue picture started to appear. By early June 2004, after most individual and corporation income tax returns were processed, it was quite apparent that both of these key revenue sources were going to exceed legislative expectations. At this same time, oil and natural gas tax revenues were mushrooming and investment earnings were improving.

The three income sources primarily responsible for Montana's revenue picture reversal are individual income, corporation income, and oil and natural gas taxes. Individual income tax has experienced increased growth resulting in large part from the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (federal tax policy changes), an improvement in wage growth (especially in real wage growth per worker), and a higher capital gains base in calendar 2003. The corporation income tax has rebounded as Montana and multi-state corporations have recovered from the 2001 recession and the effects of "9/11". Additionally, the impact of the federal stimulus bonus depreciation provisions of calendar 2002 and 2003 will now create a decrease in the amount of depreciation expense corporations can claim in future years, which will result in increased tax liabilities. Finally, both oil and natural gas prices have increased dramatically in response to the war in Iraq and uncertainty about future supplies. As a result of the higher prices, new drilling activity for oil is up substantially. Production levels are once again increasing, reversing the production declines observed during the last ten years.

The following discussion provides the projected ending fund balance for the 2007 biennium.

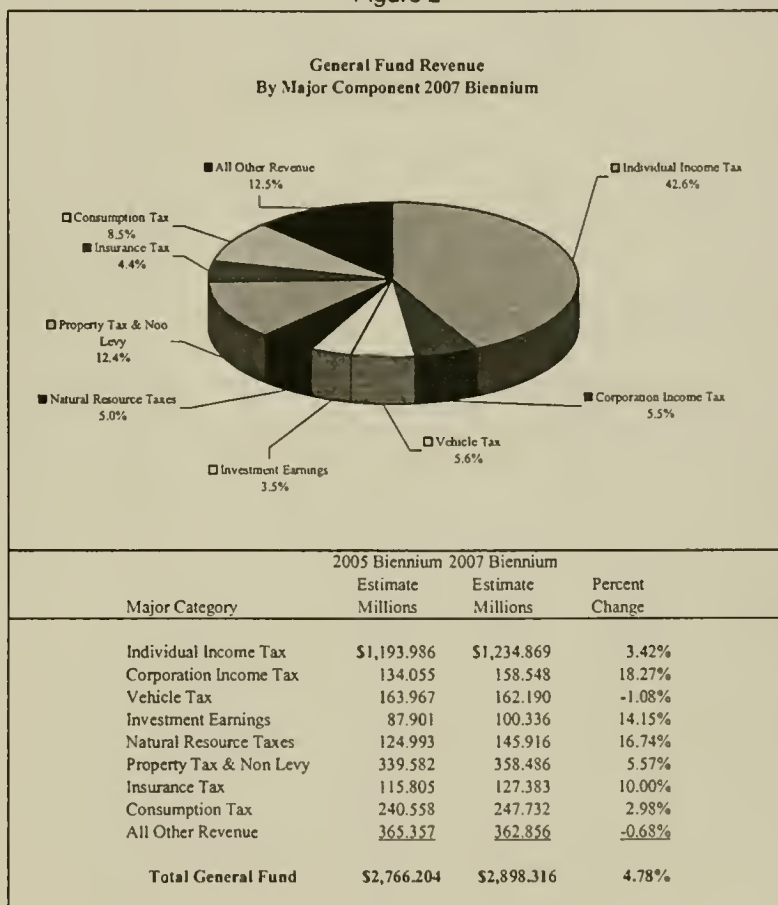
2007 BIENNIUM – PROJECTED GENERAL FUND BALANCE

The state general fund is the primary account that funds a significant portion of the general operations of state government and is often referred to as the state's checking account. This account has grown from slightly less than \$700 million in FY 1990 to almost \$1.3 billion in FY 2004, or approximately 5.0 percent annually. Figure 2 shows where the money in this account comes from by major revenue category (as estimated by the Revenue and Transportation Interim Committee for the 2007 biennium), while Figure 3 shows how the money is expended by major expenditure category (as requested in the Martz executive budget).

In the 2007 biennium, over 60 percent of total general fund revenues come from income and property taxes. Total revenues to the account for the 2007 biennium are projected to be nearly \$2.9 billion, which is an increase of \$132.1 million, or 4.8 percent from the 2005 biennium. Total general fund disbursements represent approximately 37 percent of all state expenditures in the general, state special, federal special, and selected proprietary fund types.

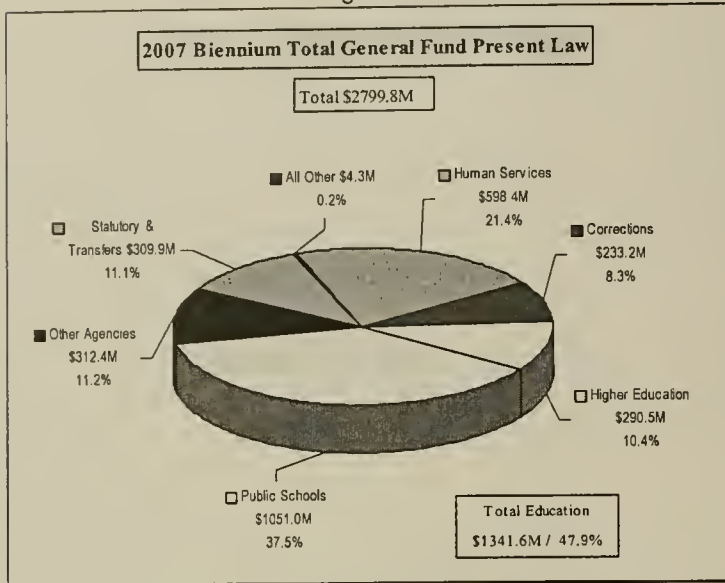
Figure 3 shows how the general revenues are expended by governmental function in the executive budget (present law only). As the figure shows, education consumes 48 percent, human services 21 percent, and corrections 8 percent of general fund revenues. It should be noted that statutory and transfer appropriation expenditures are shown separate from the agency responsible for the appropriation.

Figure 2



Balancing general fund appropriations against anticipated revenues is a major challenge of each legislative session and requires a significant coordination between the taxation and appropriation committees. Based on revenue estimates adopted by the Revenue and Transportation Interim Committee (RTIC) on November 16, 2004, there are sufficient revenues to support the executive present law budget recommendations, leaving a ending fund balance of a positive \$293.3 million (Figure 4). Because of this high balance, there are sufficient revenues to accommodate all of the executive new proposals, including the executive's recommended ending fund reserve of \$162.9 million.

Figure 3



If the total executive budget were funded as requested, the ending balance in the general fund would be \$181.3 million (Figure 4). One of the reasons for this higher projected balance than the executive is that the projected balance uses the final revenue estimate recommendations of the RTIC. The executive budget was based on lower revenue estimates developed by the executive's staff. The result is that the balanced budget as submitted by the executive exceeds the executive recommended \$162.9 million reserve when using RTIC general fund revenue estimates.

A projected general fund balance of nearly \$300 million after funding the executive present law budget leaves the legislature

with a sizeable surplus to apply toward:

- An appropriate ending fund balance reserve (the executive recommends \$80 million, and national experts recommend a minimum 3 percent -- \$87 million)
- Consideration of \$112.0 million in executive new initiatives
- Other legislative priorities and initiatives

**2007 Biennium General Fund Balance
Based on Present Law (In Millions)**

	Actual Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated 2005 Biennium	Estimated 2007 Biennium
Beginning Fund Balance	\$43.065	\$132.873	\$194.725	\$227.012	\$43.065	\$194.725
Revenues						
Current Law Revenue	1,381.565	1,384.639	1,429.143	1,469.173	2,766.204	2,898.316
Total Funds Available	\$1,424.630	\$1,517.512	\$1,623.868	\$1,696.185	\$2,809.269	\$3,093.041
Disbursements						
General Appropriations	1,161.831	1,167.626	1,243.157	1,242.405	2,329.457	2,485.562
Statutory Appropriations	126.600	128.660	133.085	135.606	255.260	268.691
Local Assistance Appropriations						
Miscellaneous Appropriations	1.866	2.385			4.251	
Non-Budgeted Transfers	10.052	17.469	20.917	20.314	27.521	41.231
Supplemental Appropriations		12.651			12.651	
Language Appropriations	1.372	0.350			1.722	
Feed Bill Appropriations		7.000	2.100	8.050	7.000	10.150
Anticipated Reversions	(19.683)	(8.979)	(2.403)	(3.452)	(28.662)	(5.855)
Total Disbursements	\$1,282.038	\$1,327.162	\$1,396.856	\$1,402.923	\$2,609.200	\$2,799.779
Adjustments	(9.719)	4.375			(5.344)	
Unreserved Ending Fund Balance	<u>\$132.873</u>	<u>\$194.725</u>	<u>\$227.012</u>	<u>\$293.262</u>	<u>\$194.725</u>	<u>\$293.262</u>
Net Operations	\$99.527	\$57.477	\$32.287	\$66.250	\$157.004	\$98.537
New Executive Proposals Not Included Above						
Revenue Initiative			\$2.932	\$3.342		\$6.274
Disbursement New Proposals						
Long Range Building			10.000	20.000		30.000
Cultural Trust Repayment			3.913			3.913
Protested Property Tax Reserve			4.000			4.000
Retirement System Funding			3.600	3.600		7.200
Executive Pay Proposal			9.508	22.036		31.544
Language Appropriations			0.887	0.705		1.592
HB2 New Proposals			<u>24.076</u>	<u>15.960</u>		<u>40.036</u>
Total Disbursement Initiative			\$55.984	\$62.301		\$118.285
Potential Ending Fund Balance Without Reserves			\$173.960	\$181.251	\$194.725	\$181.251

Figure 4

While this is an enviable position to be in, especially compared to the deficit situation just two years ago, there are a number of spending pressures to be addressed, including the K-12 court decision that schools are under-funded (not addressed in the executive budget), and employee union demands for employee pay and benefit increases. In addition, much of the surplus (\$293.3 million) would have to be used for one-time initiatives as opposed to expanding ongoing services, if a structural balance in the general fund is to be maintained (see the discussion of "Structural Balance" on page 108). Thus, while the outlook is clearly optimistic, the 2005 Legislature still faces a number of fiscal challenges. These challenges are discussed in the next section.

A more detailed discussion of the general fund projection begins on page 43 of this volume.

What are the major fiscal challenges facing the 2005 Legislature?

What are the Executive solutions?

What are the significant issues identified by the LFD analysis?



MAJOR FISCAL CHALLENGES / SOLUTIONS / ISSUES

Following a biennium in which significant service reductions were taken, some major revenue sources have taken a surprising turn. Bolstered by greater than expected individual income tax collections and higher oil prices, state revenues have increased significantly, leaving a sizable projected surplus as of the end of FY 2005. However, much of the surplus is categorized as "one-time" moneys, which implies limits on how such money should be spent. In addition, there is still strong pressure for increased funding for assorted state services.

The upcoming legislature will continue to face many fiscal challenges in their deliberations. To put the economic and fiscal picture presented in prior sections in perspective, the following summarizes key challenges and uncertainties that the legislature will have to consider in formulating the 2007 biennium spending plan and related fiscal policy. Below each is a summary of the executive proposed solution and issues raised by the LFD analysis where appropriate.

Fiscal Challenge

Funding for schools is arguably the number one fiscal challenge in view of a district court decision in April of 2004 (upheld by the Montana Supreme Court in November 2004) finding that state funding for K-12 education is not adequate and that the current funding methodology is unconstitutional. The state is directed by the court to find a solution by October 2005. The magnitude of the K-12 education budget, the complexities of determining a solution, and the limited time frame for finding a solution will make this issue difficult to resolve.

Executive Proposal: The executive budget does not address the court decision that current funding is inadequate. The Governor's request for schools provides primarily a present law increase and other inflationary items. Inflation has been applied to basic and per ANB entitlements as required by statute, and to the state contribution to special education. Other expenditure categories such as facility bond payments, block grants, and transportation received increases. Increases in funding are offset somewhat by expected enrollment reductions. The Governor's proposal includes \$28 million general fund for increases to local education activities.

Issue: Since funding to satisfy the court ruling on inadequate education funding is not included in the executive budget, the legislature will likely have to provide additional funding above the proposed budget to meet this need. Funding cannot be determined until the legislature defines "quality" education and develops a funding methodology based on educationally relevant factors (needs assessment). Since the amount of additional funding required could be substantial, this is a potential "budget buster".

**Fiscal
Challenge**

Health care cost inflation and caseload increases continue to be major contributors to greater than average growth in health care services budgets. With medical cost growth well ahead of normal inflation and prescription drug increases in double digits, there is no relief in sight. This trend follows recent years of budget reduction caused by revenue shortfalls. Add to that the growing caseloads needing services, fueled to some degree by an aging population, growing demands for increases in funding, and reductions in the federal Medicaid rate. Underestimating costs could result in a budget-breaking supplemental request or further reductions in health care services.

Executive Proposal: The executive budget maintains current services levels, while providing increases of \$83 million general fund, \$36.8 million state special revenue, and \$214.4 million federal funds. Of the general fund increase, \$32 million funds service and caseload increases and \$55 million addresses the changes in the federal match rate.

Issue: All state governments, and Montana is no exception, deal with the impact of rising medical costs. Nationally, it is estimated that 10 percent of state expenditures are for medical costs, which include payments for state employee health benefits, Medicaid services, state Children's Health Insurance Programs (CHIP), and medical services provided and paid for by state institutions. The legislature may wish to study whether there is a way for state funded health services to either be combined or to learn from each plan's cost control methods for Montana to realize savings.

**Fiscal
Challenge**

Correctional offender population continues to grow. From FY 1997 through FY 2004, the number of offenders in both secure custody and community supervision increased from 7,453 to 10,353, a growth of 3.9 percent. The average daily population for FY 2004 is estimated to have a 4.5 percent increase over FY 2003. Controlling expenditures in this area of the budget can go way beyond simply funding incarceration or supervision programs. It requires legislators to look at sentencing criteria, alternative correction programs, ways to rehabilitate offenders more quickly, and ways to keep people out of the criminal justice system.

Executive Proposal: General fund expenditures for the 2007 biennium increase \$24.1 million or 11.5 percent, when compared to the 2005 biennium. In addition to statewide present law adjustments, increases anticipate more than a 4 percent growth in population each year, and include additional probation and parole officers and an increase in private contract beds, both intended to deal with the growing population.

Issue: All of the secure facilities, with the exception of the private prison in Shelby, will be well above their rated capacities or at or above their operational capacities during some point in the 2007 biennium. The Shelby facility would be expanded to meet future growth.

**Fiscal
Challenge**

Higher education has been funded to a greater and greater degree in recent biennia with increased tuition charges to students, as general fund becomes a smaller share of total funding. The legislature will need to reconcile the difference between what the total state funded share of higher education should be, and what the state can afford.

Executive Proposal: The Governor's proposal includes funding for the resident student share of present law adjustments with general fund, with the intent of minimizing tuition increases. According to the executive budget, if the Board of Regents adopts the Governor's statewide adjustment proposals and the 3 percent pay plan proposal, the required tuition increase should only be 2 percent per year. This compares to a system-wide average of 11 percent for the 2005 biennium.

Issue: Board of Regents projections do not appear to agree with those of the executive. The board projects tuition increases ranging from 4.3 to 11.7 percent, depending on the state level of funding in HB 2, the state share calculation that is used in HB 13 (pay plan), and the actual level of funding the Board of Regents allocates to specific university level new initiatives.

**Fiscal
Challenge**

State employee pay and benefits are likely to be a hot topic for the 2005 session. State employees received no salary increase in FY 2004 and a 25-cent per hour increase in FY 2005, which was delayed to take effect mid-year. However, the state contribution to employee health insurance benefits attempted to keep pace with the growth in those costs, costs that continue to climb. With the revenue picture improved, state employee union representatives will likely seek some redress of employee compensation issues.

Executive Proposal: The executive pay plan proposal provides for a 3 percent increase October 1 each year of the biennium, plus increases in the state contribution to health insurance of \$46 per month for FY 2006 and an additional \$51 per month in FY 2007. The increases in the state contribution for insurance take effect on July 1 of each year for university system employees and January 1 for all other state employees.

Issue: As of this printing, there is no negotiated agreement between the executive and employee groups. Therefore, it is not known what the employee representatives' position is in regard to pay and benefits demands, and the executive proposal.

**Fiscal
Challenge**

Public employee retirement funds have suffered from lower interest rates and equity market losses. Reduced investment earnings have resulted in actuarial estimates of unfunded liabilities that exceed acceptable levels.

Executive Proposal: The Martz budget proposes: 1) to temporarily increase the employer contributions to the plans and 2) various plan changes that would impact benefit calculations for future employees (members). The proposed budget provides \$7.2 million for increased employer contributions. Legislation is proposed to effect benefit changes for future public employees, although current versions of the legislation differ from the assumptions contained in the executive budget.

Issue: The temporary employer contribution increases are expected to address the current unfunded liabilities, but what impacts will member demographics have on future unfunded liabilities? Additionally, even though an unfunded liability exists, there is the potential to erase the liability with stronger investment return. The state has no legal obligation to address the unfunded liability in this session, and the question is more of an assessment of responsible fiscal management.

**Fiscal
Challenge**

Management of capital assets is an important function of state government. A key component is the maintenance of state facilities and other assets. The deferral of such maintenance has been a long-standing issue, made worse by the budget shortfalls of recent years. Delaying maintenance activities can result in higher future costs as facilities deteriorate beyond the need for ordinary repairs and replacements.

Executive Proposal: The highest priorities in the cash portion of long-range building proposals are for repair and maintenance activities. The executive proposes a one-time expenditure of \$30 million from the general fund to “reduce the growing statewide backlog of safety, major repairs, and deferred maintenance projects”. This is in addition to a projected cash balance of \$5.1 million in the long-range building fund, for a total amount of \$35.1 million.

Issue: There is not a clear picture of what the total deferred maintenance exposure currently is, although it is roughly estimated to exceed \$100 million. The legislature may want to request a more accurate estimate, a long-range plan for addressing deferred maintenance, and an assessment of the risks associated with deferred maintenance.

**Fiscal
Challenge**

Public defender services were the topic of a subcommittee of the legislative Law and Justice Interim Committee during the 2003-2004 interim. Partially in response to a pending lawsuit (on hold until May 2005), the subcommittee drafted legislation to create a statewide public defender system to address issues raised by the American Civil Liberties Union (ACLU) in its lawsuit. The ACLU alleges that public defender services are not provided throughout the state in an equitable manner and that it is a conflict of interest when a judge appoints a public defender in a case that will be heard by that judge.

Executive Proposal: The executive budget does not address the potential statewide public defender system. It will be presented in legislation (LC 0214) crafted by the interim committee.

Issue: The current estimate of the additional ongoing cost of the statewide public defender system is \$6.0 million (\$3.5 million for the transitional 2007 biennium). These costs include payments for public defender services provided by seven county-managed public defender offices throughout the state, services provided by private attorneys, transcripts, private investigator services, and witness fees and expenses.

**Fiscal
Challenge**

Pending litigation and subsequent court rulings can impact state finances. Currently, there is one legal action pending that seeks changes and increased funding for services for the developmentally disabled: the Montana Association for Independent Disability Services, Inc. (MAIDS) lawsuit. Another lawsuit pending at this time relates to compensation issues for highway patrol officers and could result in an award of back pay. In addition, during FY 2004, two decisions were rendered that are expected to have potential fiscal impact in the upcoming biennium: 1) the Montana Advocacy Program (MAP) Travis D. class action lawsuit; and 2) the lawsuit which challenged the adequacy of state funding for schools (discussed on page 119 under “K-12 Lawsuit Issue”).

Executive Proposal: The executive budget for the Department of Public Health and Human Services includes elements of the Travis D settlement agreement.

Issue: The settlement agreement in the Travis D. litigation requires that the Department of Public Health and Human Services take several actions, including proposals for some statutory changes during both the 2005 and 2007 legislative sessions, movement of 45 individuals from the Montana Developmental Center to community settings, and a number of other items, some of which have budgetary impacts. The potential liability in the other pending litigation is unknown, but could be substantial. The legislature should be aware of this liability as it crafts the 2007 biennium budget.

**Fiscal
Challenge**

Supplemental emergency appropriations for the next biennium are not budgeted by the legislature and not accounted for in the ending fund balance. The state continues to experience supplemental appropriations each biennium, particularly for fire suppression, although for FY 2005, no fire costs supplemental is expected. Fire costs for FY 2005 were funded by a one-time federal grant. For any future biennium, the legislature needs to keep in mind that supplemental appropriation requests are common, with general fund supplemental appropriations averaging \$29 million per biennium over the past 10 biennia.

Executive Proposal: The executive budget includes general fund supplemental appropriation requests totaling \$12.7 million for FY 2005 (see page 77). Supplemental appropriations for the 2007 biennium will be addressed in HB 3 of the 2007 session.

Issue: Neither the executive nor the legislature includes projections for supplemental appropriations in the 2007 biennium. Typically, the potential for supplemental appropriations is considered a component of the fund balance reserve. This speaks to the need for an adequate reserve, which is discussed later.

**Fiscal
Challenge**

State assumption of district courts has been a difficult issue for the Judiciary since its implementation through SB 176 in the 2001 session. Although questions of who pays for what costs have been answered, there are still concerns that the program is underfunded. A sizable supplemental of \$5.8 million is requested for FY 2005 and this is also reflected in the Judiciary's request for the next biennium.

Executive Proposal: The executive budget includes a Judiciary budget that is \$7.8 million less than the Judiciary submission. According to 17-7-122, MCA, the Judicial Branch budget proposal is included in the executive budget proposal, but the executive does not have to include expenditures above the current base as part of the balanced budget. The executive does, however, list the decision packages that are not included in the Martz budget.

Issue: Since the implementation of SB 176 in 2001, the Judicial Branch has indicated that its budget to pay for the district court assumption was not adequately funded. The budget for the district court assumption is split into fixed and variable costs. The fixed costs primarily are comprised of employee payroll costs while variable costs are primarily for public defender services. One difficulty has been that the Judiciary does not budget and account for variable costs in a way that clearly reports those costs or offers an opportunity to control those costs. Before the variable costs can be fully addressed in the budget, there needs to be better accountability for those costs.

**Fiscal
Challenge**

Potential **loss of federal funds** as a source of funding for many state and federal programs is a concern because of the large federal deficit and the administration's goal of cutting the deficit in half by 2008. The loss of federal funds translates to either reductions in services to citizens or increased state costs to offset the loss, loss of jobs in the state, and loss of "imported" money into the Montana economy.

Executive Proposal: The executive budget includes \$3.2 billion in federal funds for the 2007 biennium, a \$311.8 million, 10.8 percent increase over the 2005 biennium.

Issue: The Montana budget has an increasing reliance on federal funds, as federal funds comprise 46.7 percent of the total proposed HB 2 budget. A significant federal cutback could have a devastating impact on government services in Montana and/or the state budget.

**Fiscal
Challenge**

Long-term stability of the general fund becomes an issue when changing demographics become a big player in the demand for government services or are an influencing factor in the generation of state revenue. Emerging examples of potential instability are: 1) the aging population of Montana as well as other states; 2) dependence on revenue from the cigarette tax that is partly intended to discourage the use of tobacco products that generate the tax revenue; 3) the education funding lawsuit liability; and 4) the federal funds reliance issue discussed above.

Executive Proposal: The executive budget does not address this issue.

Issue: The legislature needs to be cognizant of the long-term outlook for the general fund if a future budget crisis is to be avoided. The legislature may wish to consider an interim study of the long term stability of the general fund.

**Fiscal
Challenge**

Economic development has been a high priority for the Martz administration. Governor-elect Schweitzer campaigned strongly on economic development initiatives. What investment will be necessary to continue current efforts and/or fund new initiatives?

Executive Proposal: The most significant new initiative that relates to economic development is the "Shared Leadership for a Stronger Montana Economy" project of the Montana University System. The executive budget includes \$9.9 million of general fund moneys for several new proposals related to this project.

Issue: As is true for many economic development efforts, there needs to be accountability for the investment that is committed to the project. Measurable goals and objectives, and related accountability measures, are critical in determining the effectiveness of these efforts.

**Fiscal
Challenge**

Controlled budget growth (structural balance) will continue to be a concern, regardless of the sizable projected fund balance expected for the end of the 2005 biennium. A large portion of the available general fund revenues is from a one-time source. Temptations to use “one-time” revenue for “ongoing” programs and services will persist.

Executive Proposal: The executive budget is structurally balanced. This is demonstrated by the difference between the projected revenue and the ongoing expenditures. For FY 2006, revenue is projected at \$1,411.7 million and ongoing expenditures at \$1,386.6 million. For FY 2007, revenue is projected at \$1,455.9 million and ongoing expenditures at \$1,430.7 million. In each case, revenues exceed ongoing expenditures by about \$25 million.

Issue: While the executive uses an “ongoing” expenditure amount in its calculation of structural balance, it uses all projected revenues. One might argue that a portion of the projected revenues should not be included as “ongoing”. For example, the current level of oil and gas revenues might not be maintained, since oil prices have already begun to drop. This is a lesson that almost all states should have learned about the growth experienced in mid to late 90’s, and leading up to the 2001 recession. For most states, revenue growth slowed significantly with the recession, stranding inflated expenditure levels without an adequate funding stream. Severe expenditure reductions and depleted “rainy day funds” were the norm for a few years following.

**Fiscal
Challenge**

Adequacy of the ending fund balance reserve will need to be monitored by the legislature as the session progresses. What will it take to ensure that Montana keeps an adequate “safety net” in place?

Executive Proposal: The executive budget includes a \$162.9 million projected fund balance at the end of the 2007 biennium, but recommends that the legislature leave at least an \$80 million ending fund balance when a final budget is passed.

Issue: While this is well above the recommended minimum fund balance, other spending demands will likely compete for a share of this balance. National experts consider a 3 percent reserve to be a minimum (\$87 million). The legislature should be looking at retaining at least a \$75 million dollar reserve as a safety net. Montana is one of only three states without a rainy day fund and may also want to consider setting up and placing seed money in a “rainy day fund”, as is being proposed by more than one legislative bill this session.

**Fiscal
Challenge**

Economic uncertainties can undermine revenue-forecasting efforts, and contribute to an increased demand for government services in areas such as human services and corrections. As in any legislative session, there are many unknowns surrounding revenue forecasts. Oil and gas prices appear to be declining, interest rates are slowly increasing, and there is more talk at the federal level of income tax reform. Assumptions used in the revenue forecasting process are based upon the best information available, but what might happen to change those assumptions?

Executive Proposal: The executive budget is based on revenue estimates that are \$14.0 million below those adopted by the Revenue and Transportation Interim Committee.

Issue: The current national economic picture is volatile at best, and with the inherent increase in government service demands and eligibility, are revenue estimates conservative enough, and can budgets be contained without cost over-runs?

**Fiscal
Challenge**

General fund spending without HB 2 appropriations occurs in general fund non-budget transfers and through statutory appropriations. Authority for such spending is authorized in statute, but doesn't receive the usual scrutiny that HB 2 appropriations require. The challenge in this case is for the legislature to minimize the occurrence of spending that does not require regular scrutiny by the legislature.

Executive Proposal: The executive budget does not address this issue.

Issue: The legislature has established numerous statutory appropriations and transfers in statute, expenditures that do not receive the same scrutiny or prioritization as HB 2 appropriations. Statutory appropriations for the 2007 biennium are estimated to be \$269 million general fund and transfers are estimated to be \$41 million.

What are the key features of the executive budget?



EXECUTIVE 2007 BIENNIUM BUDGET HIGHLIGHTS

INTRODUCTION

As discussed in the preceding sections, the revenue picture is much improved since the 2003 session, but there are many challenges facing the 59th Legislature. As with every session, legislators will consider hundreds of bills, many of which will generate revenues or result in additional state spending. From a fiscal perspective, the most important of these bills is the general appropriations act (HB 2). The executive budget proposal is represented in HB 2, as well as other legislation and existing law. What are the key features of the executive budget?

GOVERNOR'S BUDGET POLICIES AND PRIORITIES - HIGHLIGHTS

This section provides a brief overview of the overall budget policies and priorities in the Martz budget to fund state government. Revenue proposals are discussed in more detail in the "Executive Revenue Proposals-Summary" section on page 59 and expenditure proposals are summarized in the "Executive Expenditure Proposals-Summary" section on page 61. Volumes 3 and 4 of this publication contain the detailed discussion of each agency. Following are highlights of key issues of the budget.

TOTAL BUDGET SUMMARY

The executive budget proposal for HB 2, the general appropriations act, totals \$6.9 billion for all funds, of which \$2.5 billion is general fund. The executive includes total spending increases for the 2007 biennium (as compared to the 2005 biennium) of \$227.9 million general fund and \$654.6 million total funds. This represents biennial increases of 9.9 percent general fund and 10.6 percent total funds. General fund is distributed as follows:

- 54 percent goes to education (K-12 and higher education) - \$1,358 million
- 24 percent goes to human services - \$604 million
- 9 percent goes to corrections - \$235 million
- 13 percent goes to all other government (over 20 agencies) - \$330 million

Outside of HB 2 appropriations, the executive spending plan includes other legislatively authorized general fund expenditures:

- Statutory appropriations - \$269 million, including \$170 million for distribution to local government
- Non-Budgeted Transfers - \$41 million

HIGHLIGHTS OF REVENUE PROPOSALS

The executive budget proposal does not propose any major tax policy initiatives. There are, however, two minor revenue initiatives that would increase general fund revenues in the 2007 biennium.

- Paying-off the Department of Revenue Computer System loan of \$16 million has an offsetting impact on revenues because it would eliminate a need to assess a fee of general fund revenues authorized by the 2003 Legislature, increasing general fund revenues by \$6 million in the 2007 biennium.
- A request for an additional pathologist position for the Department of Justice forensic lab would result in additional general fund revenue of \$0.3 million in the 2007 biennium, by billing the counties for which the services are provided.

HIGHLIGHTS OF EXPENDITURE PROPOSALS

The 2007 biennium executive expenditure proposals for HB 2 include recommendations for an additional:

- \$228 million general fund, a 9.9 percent increase
- \$115 million state special revenue, an 11.6 percent increase
- \$312 million federal funds, a 10.8 percent increase

The following summarizes the majority of the executive spending plan.

- General fund increases are dominated by increases for the highest cost policy areas: human services, K-12 education, higher education, and corrections. There are also significant increases for the Judiciary and the Department of Revenue. Increases for these program areas are summarized below.
- Present law changes are dominated by four factors:
 - Payout of debt and settlement obligations
 - Increasing caseloads in various human service programs
 - Increases for statewide present law adjustments (including full funding of personal services less vacancy savings, fixed costs, and inflation)
 - Reductions that continue some of the FTE reductions taken in the last session.
- General fund new proposals are dominated by computer system completion, development, or enhancement in several agencies; the "shared leadership" project and new equipment in higher education; various program enhancements in human services; and increases for various K-12 allocations to schools.
- FTE increase by a net of 106.09 FTE in FY 2006 and 91.16 FTE in FY 2007.

Major Program Areas

Human Services

Human services would receive a 16 percent general fund increase over the 2005 biennium, reflecting caseload increases and various service enhancements. A higher required state match rate for Medicaid services that increases general fund reduces federal funds by a like amount.

K-12 Education

The executive budget seeks a \$28 million, or 2.7 percent, general fund increase for elementary and secondary education, primarily due to statutory inflationary adjustments. An increase of \$19 million in other funds is almost entirely due to additional federal grants.

Higher Education

Higher education receives a \$22.4 million, or 8.1 percent increase, in general fund and a \$6.9 million in

other funds – the executive proposal addresses an increased state general fund share to keep tuition increases down, its “shared leadership” economic development initiative, and new equipment for the two year schools, as primary drivers of this increase.

Corrections

Corrections receives a \$24.1 million, 11.5 percent general fund increase, largely for population increases in both secure care and community corrections, and to manufacture the new issue license plate.

Judicial Branch

The Judiciary, under the executive proposal, receives a \$12.2 million, 20.8 percent general fund increase over the 2005 biennium, due primarily to higher district court costs.

Revenue

The Department of Revenue seeks a \$33.9 million, 60 percent general fund increase in spending, primarily for computer system projects – \$16 million of which is to pay off the financing of the initial phase of the IRIS project (POINTS replacement).

Vacancy Savings

The executive applied a 4 percent per year vacancy savings factor that reduces agency budgets by \$49 million total funds, including approximately \$19.1 million general fund.

Major Changes in Executive Proposals

Figure 5 lists the major individual components of the general fund increase included in the executive budget. The amounts shown are based upon a comparison of the 2007 biennium budget with the FY 2004 base (multiplied by 2 for the comparison). The comparison is shown this way because the budget for both years of the 2007 biennium is built from the FY 2004 base.

Figure 5

Major Factors - General Fund Increase From the Doubled FY 2004 Base 2007 Executive Budget			
Element	Funds (in millions)	Percent of Total	Cumulative Percent
Doubled 2004 Base	\$ 2,275.6	—	—
Major Adjustments - \$250.0 million			
Medicaid Matching Rate*	\$ 55.0	22.0%	22.0%
Human Services Caseloads and Service Changes	38.3	15.3%	37.3%
Corrections Populations and Overtime	24.0	9.6%	46.9%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	9.2%	56.1%
MUS Enrollment/K-12 Enrollment Inflation	19.4	7.8%	63.9%
Statewide Present Law Adjustments	15.4	6.2%	70.0%
Computer Systems Update/Completion/Replacement	13.5	5.4%	75.5%
MUS Shared Leadership/Equipment	9.9	4.0%	79.4%
DPHHS Institutional Costs (overtime, utilities, etc.)	6.6	2.6%	82.1%
License Plate Manufacture/Replacement**	4.5	1.8%	83.9%
Emergency Telecommunications	4.1	1.6%	85.5%
All Other Agencies	36.2	14.5%	100.0%
Total 2007 Biennium	\$ 2,525.6	100.0%	

*Includes \$1.1 million for non-Medicaid expenditures that use the Medicaid matching rate.

**Includes expenditures in corrections and the Department of Justice

Other Features of the Executive Budget (not in HB 2)**Statutory Appropriations**

Statutory appropriations and local assistance have a total estimated cost of \$269 million, of which \$170 million is for distribution to locals - these local government entitlements increase by \$5.5 million for inflation.

Executive Pay Plan

The employee pay plan (HB 13) provides a 3 percent salary increase on October 1 of each year and an increase in the state's share of the employee health insurance, at a total cost of \$58 million, with about \$31 million being general fund.

Supplementals

Supplemental appropriation requests for FY 2005 (HB 3) total \$12.7 million general fund – the largest being for the Judicial Branch, the Department of Corrections, and the Department of Public Health and Human Services.



OTHER FISCAL ISSUES

INTRODUCTION TO OTHER FISCAL ISSUES

The Legislative Fiscal Division analysis also includes several fiscal issues not directly related to the executive budget, but that will potentially have an impact on the budget passed by the legislature and/or the budget process. These fiscal issues are varied and sometimes complex. It is important that the legislature be aware of them in its deliberations. The following briefly describes each issue. These issues are described in more detail later in this volume under the title, "Other Fiscal Issues to Consider." Page references are provided for each issue.

- **K-12 Lawsuit Issue.** The district court decision found the state's share of school district spending inadequate, and found that Montana's funding formula is not reasonably related to the costs of providing a basic system of free quality public elementary and secondary schools. The Montana Supreme Court subsequently upheld the decision. The conclusion of the District Court and the Supreme Court is that until such time as the legislature assesses education needs and defines "quality", it is not in a position to construct a funding system rationally related to educationally relevant factors. The state is directed by the court to find a solution by October 2005. (Page 119)
- **Other Litigation Issues.**
 - *Human Services.* In September 2002, the Montana Association for Independent Disability Services, Inc. and several individuals with developmental disabilities filed suit that several statutory and constitutional provisions have been violated. A finding in favor of the plaintiffs and requiring the state to reimburse contractors at a level that provides direct care wage rates that are comparable to state employees would likely have a financial impact on the developmental disabilities system that would be measured in terms of millions of dollars. Another lawsuit, the Travis D. litigation, was a class action lawsuit on behalf of individuals with developmental disabilities for which a court ordered settlement agreement of this litigation was signed. (Page 124)
 - *Highway Patrol Class Action Lawsuit.* This is a class action lawsuit that includes 323 officers seeking overtime compensation for all lunch hours for a period of 3½ years and to have overtime and retirement contributions and benefits recalculated based on the contention that subsistence pay should have been included in the officers' base pay. A settlement agreement has been signed by the parties to the lawsuits that indicates a settlement amount of \$8.5 million. (Page 124)
 - *PPL Protested Taxes.* Protested taxes are currently deposited into the general fund for support of government services. Because of the uncertainty of these moneys, the executive is proposing in legislation to transfer half of the protested taxes to a state special revenue account to be available for potential refunds. The legislature is being asked to determine an approach that is prudent for the state. (Page 125)

- **Tobacco Settlement Funds.** Montana receives revenue as a settling party to a Master Settlement Agreement. Of \$42 million expected in the 2007 biennium, 40 percent is earmarked for the Tobacco Trust, 32 percent funds tobacco prevention programs (the executive is proposing to divert a portion of this allocation to other uses), and 17 percent funds the Children's Health Insurance Program. The remaining 11 percent is to be deposited in the general fund. Anticipated interest earnings of \$7.9 million from the trust must be allocated 10 percent to the trust and 90 percent as appropriations for disease prevention and programs providing benefits, services, or coverage related to the health care needs of Montana citizens (Page 126)
- **I-149: Cigarette and Tobacco Tax Increases.** Montana voters approved Initiative 149 in November 2004, increasing the tax on cigarettes and other tobacco products. The annual increase in revenues would be nearly \$40 million. The initiative also changed the distribution of the tax revenue, by reducing the general fund share and the long-range building program share, maintaining the veterans home share, and creating a new account for health and Medicaid initiatives. In effect, however, the dollar share for the general fund is nearly the same, while the other areas see increases. The health and Medicaid initiative account receives most of the total increase. (Page 129)
- **Jobs and Growth.** In response to severe fiscal shortfalls experienced by almost all states in FY 2002 and FY 2003, Congress passed legislation providing fiscal relief to states. Called the Jobs and Growth Tax Relief Reconciliation Act of 2003, the legislation consisted of two types of fiscal relief: 1) a temporary increase in the federal Medicaid benefits participation rate; and 2) a grant of \$50 million. (Page 134)
- **Public Defender Study.** The Law and Justice Interim Committee is proposing legislation to establish a statewide public defender system. A related lawsuit, filed by the American Civil Liberties Union, is on hold pending the outcome of legislation. The current estimate of additional costs for the statewide system is \$3.5 million for the 2007 biennium (\$6.0 million ongoing). (Page 137)
- **District Court Assumption.** The Supreme Court's assumption of the district courts has presented some challenges, including significant cost over-runs, resulting in a supplemental funding request for FY 2005. This supplemental is mostly due to expenditures for public defender services provided by appointed, contracted or county-managed public defenders. (Page 139)
- **Medicare Modernization Act.** The federal Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) was signed into law in December 2003. The most significant change due to passage of the MMA is the addition of an outpatient prescription drug benefit (Part D) for Medicare beneficiaries. Despite state and federal implementation issues, outpatient drug assistance is a significant benefit for Medicare beneficiaries. To date, there are many undefined aspects of the MMA, including the underlying data needed to calculate the fiscal effects. (Page 140)

- **Long-term Stability of the General Fund.** The state general fund is the primary account that funds a significant portion of the general operations of state government. Since this fund is critical to the operations of state government, the long-term stability of this account is an issue that must be examined for development of sound fiscal policies. There are three key issues relevant to the ensuing legislative session and the necessary planning for subsequent sessions. They are 1) revenue stability, 2) reliance on federal funds, and 3) funding demands. (Page 142)
- **Statutory Appropriations.** Expenditures from statutory appropriations in the 2007 biennium are estimated at \$269 million. Entitlement payments to local governments account for \$170 million. These appropriations become a greater concern, as the legislature does not automatically review the amount of money appropriated in the same manner as appropriations in HB 2. (Page 148)
- **General Fund Transfers.** Transfers, estimated to be \$41.2 million from the general fund to other funds in the 2007 biennium, continue to be at relatively high levels, primarily because of the impacts of HB 124 (2001 session), which reallocated revenue to the state that had formerly gone to local jurisdictions. Like statutory appropriations, these transfers and their authorizations are in statute and are not part of the biennial budgeting process, meaning that the monies are not part of the budget prioritization process to the same extent as other general fund monies. (Page 151)
- **Fund Balance Adequacy/Reserves.** Ensuring that there are sufficient revenues to fund state programs is one of the responsibilities of the legislature. The legislature's challenge is to ensure that there is an adequate fund balance reserve to protect the state spending plan from unexpected events. The executive budget contains a projected ending fund balance in excess of \$160 million, but recommends an \$80 million balance. (Page 154). The LFA suggestion is a minimum \$87.0 million reserve.
- **Other Major Funds.**
 - *Highway Special Revenue Account.* The 2005 legislature is faced with a declining working capital balance in the highways state special revenue account. The account is projected to end FY 2007 with a working capital balance of \$19.1 million, which is down from a \$39.1 million balance at the end of FY 2004. Projections indicate that expenditures will exceed revenues by \$19.0 million in the 2007 biennium, with the imbalance continuing in future biennia. (Page 156)
 - *Resource Indemnity Trust.* The projected ending fund balance (June 30, 2005) of the Resource Indemnity Trust (RIT) exceeds the \$100 million threshold. Therefore, the excess, estimated at \$252,844, is available for appropriation. In addition, of seven accounts that have historically received allocations of Resource Indemnity and Ground Water Assessment Taxes or Resource Indemnity Trust interest earnings, two are projected to have negative balances by the end of the 2007 biennium. The legislature will need to address the distributions of RIT funding streams to insure a balance between revenues and disbursements. (Page 157)

GENERAL FUND OUTLOOK

LFD Perspective





GENERAL FUND ANALYSIS

OVERVIEW

The state general fund is the primary account that funds a significant portion of the general operations of state government and is often referred to as the state's checking account. This account has grown from slightly less than \$700 million in fiscal 1990 to almost \$1.3 billion in fiscal 2004, or approximately 5.0 percent annually. Figure 1 shows where the money in this account comes from by major revenue category, while Figure 2 shows how the money is expended by major expenditure category. The information shown in both figures represents actual data for fiscal 2004.

In fiscal 2004, 61 percent of total general fund revenues came from income and property taxes. Total revenues to the account for the 2007 biennium are estimated to be nearly \$2.9 billion, which is an increase of \$132.1 million, or 4.8 percent from the 2005 biennium.

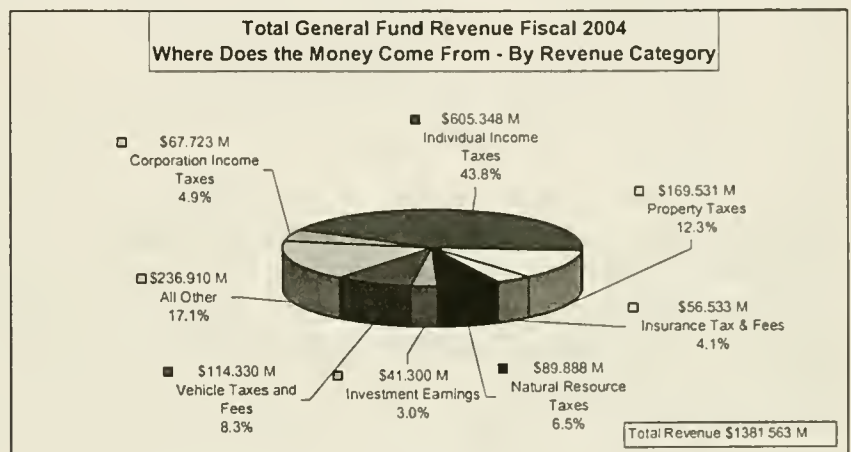


Figure 1

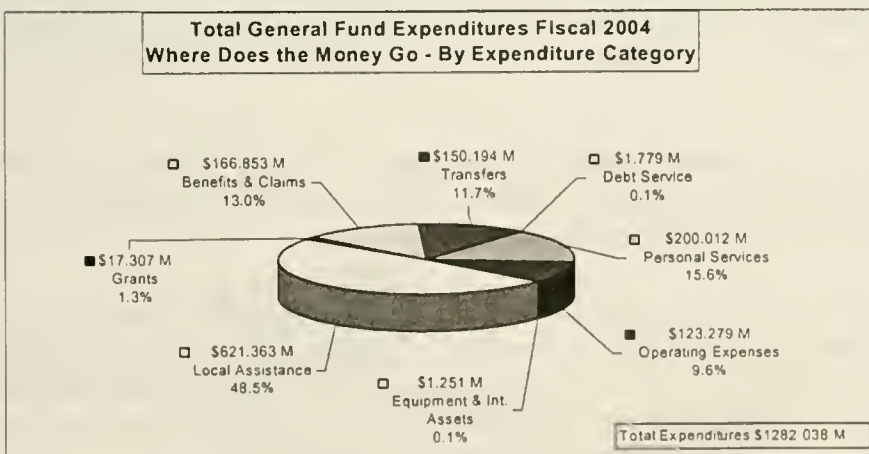


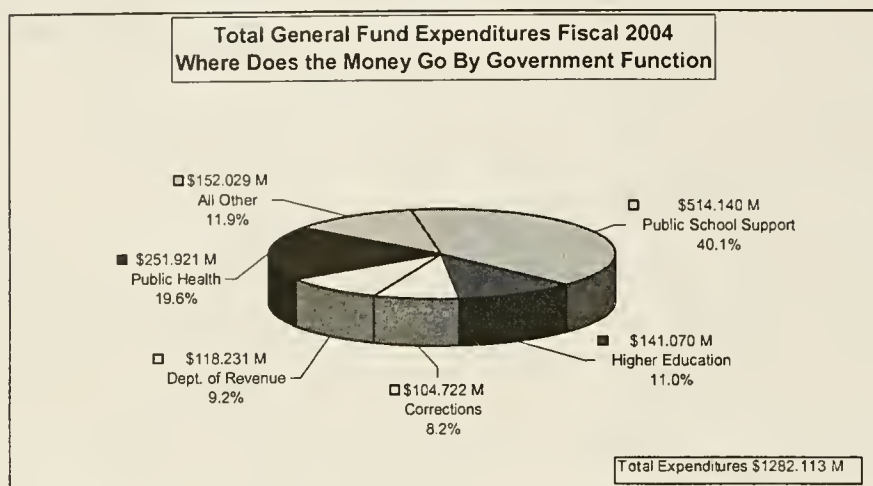
Figure 2

As shown in Figure 2, about 25.3 percent of the general fund revenue is expended for personal services and operating costs with most of the remainder disbursed for local assistance, human service benefits, and grants. This indicates that the cost of government is weighted heavily towards local assistance (local government entities including public schools) and direct human

service benefits. Total general fund disbursements represent approximately 37 percent of all state expenditures in the general, state special, federal special, and selected proprietary fund types.

Figure 3 shows how the general revenues are expended by governmental function. As the figure shows, education consumes over 51 percent, human services almost 20 percent, and corrections about 8 percent of general fund revenues. It should be noted that statutory and transfer appropriation expenditures are shown under the function that is responsible for the payment. For example, the Department of Revenue (DOR) is responsible for local government entitlement payments. Although these expenditures are made with a statutory appropriation, these costs are included with total DOR expenditures.

Figure 3



Balancing general fund appropriations against anticipated revenues is a major challenge of each legislative session and requires a significant coordination between the taxation and appropriation committees. Based on revenue estimates adopted by the Revenue and Transportation Interim Committee (RTIC) on November 16, 2004, there are sufficient revenues to support the executive present law budget recommendations, leaving a ending fund balance of a positive \$293.3 million.

Because of this high balance, there are sufficient revenues to accommodate all of the executive new proposals, including the executive's recommended ending fund reserve of \$162.9 million. If the total executive budget were funded as requested, the ending balance in the general fund would be \$181.3 million. One of the reasons for this increased balance is that the projected balance uses the final revenue estimate recommendations of the RTIC. The executive budget was based on lower revenue estimates developed by the executive's staff. The result is that the balanced budget as submitted by the executive exceeds the recommended \$162.9 million reserve when using RTIC general fund revenue estimates.

The next section of the budget analysis provides a summary of the general fund account as projected through the 2005 biennium. It begins with a reconciliation of the current (2005 biennium) projected fund balance in order to arrive at the beginning balance for the 2007 biennium.

The 2005 biennium analysis is followed by a summary of the 2007 biennium economic assumptions and associated revenue estimates as adopted by RTIC, including a graphic view of the significant revenue components. Additionally, a summary of the projected present law general fund balance using RTIC revenue estimates is shown. A projected general fund balance is also shown when the executive new proposals are included.

Finally, the differences between the executive proposed fund balance and the balance using RTIC revenue estimates and LFD statutory disbursement and reversion computations are explained.

2005 BIENNIUM GENERAL FUND PROJECTION

After completion of the Fifty-eighth Legislature, the unreserved ending general fund balance for the 2005 biennium was projected to be \$46.2 million (Figure 4). This balance was based on: 1) revenue estimates adopted in HJR 2; 2) LFD statutory appropriation and reversion estimates; 3) all general fund appropriations authorized by the legislature; and 4) the estimated impacts of all enacted revenue legislation. The Fifty-eighth Legislature did not budget for any supplemental or emergency appropriations.

As Figure 4 shows, the revised unreserved general fund balance at the end of the 2005 biennium is now projected to be \$194.7 million. This revised projection is based on: 1) revenue estimates adopted by RTIC on November 16, 2004; 2) LFD statutory appropriation and reversion estimates; and 3) supplemental appropriation recommendations by the executive. This projected balance equals 7.1 percent of anticipated revenues for the 2005 biennium and is \$148.5 million above the balance anticipated after adjournment of the 58th Legislature.

The increase in the projected general fund balance is due to several factors that have transpired since the adjournment of the 58th Legislature. Total general fund revenues are expected to be \$120.3 million more than anticipated, while disbursements are expected to be \$7.0 million less than authorized by the legislature. Fund balance adjustments are expected to be a negative \$5.3 million. Fund balance adjustments were not anticipated by the 58th Legislature.

Figure 5

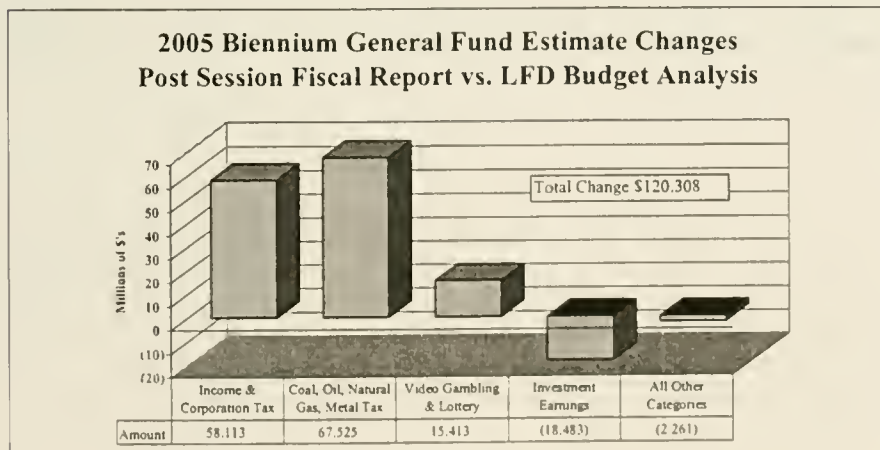


Figure 4

Comparison of 2005 Biennium General Fund Balance Post Session Budget vs. LFD Budget Analysis (In Millions)			
	Regular Session 2005 Biennium	Budget Analysis 2005 Biennium	Difference 2005 Biennium
Beginning Fund Balance	\$16.521	\$43.065	\$26.544
Revenues			
Current Law Revenue	2,645.895	2,766.204	120.309
Total Funds Available	\$2,662.416	\$2,809.269	\$146.853
Disbursements			
General Appropriations	2,319.761	2,329.457	9.696
Statutory Appropriations	259.768	255.260	(4.508)
Miscellaneous Appropriations	6.350	4.251	(2.099)
Non-Budgeted Transfers	31.165	27.521	(3.644)
Supplemental Appropriations		12.651	12.651
Language Appropriations	0.646	1.722	1.076
Feed Bill Appropriations	6.699	7.000	0.301
Anticipated Reversions	(8.191)	(28.662)	(20.471)
Total Disbursements	\$2,616.198	\$2,609.200	-\$6.998
Adjustments		(5.344)	(5.344)
Projected Ending Fund Balance	\$46.218	\$194.725	\$148.507

The improved revenue condition (\$120.3 million) can be attributed to the factors shown in Figure 5. As shown in the figure, the three income sources primarily responsible for Montana's revenue picture reversal are individual income, corporation income, and oil and natural gas taxes. Individual income tax has experienced increased growth resulting in large part from the

federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (federal tax policy changes), an improvement in wage growth (especially in real wage growth per worker), and a higher capital gains base in calendar 2003. The corporation income tax has rebounded as Montana and multi-state corporations have recovered from the 2001 recession and the effects of "9/11". Additionally, the impact of the federal stimulus bonus depreciation provisions of calendar 2002 and 2003 will now create a decrease in the amount of depreciation expense corporations can claim in future years. This will result in increased tax liabilities. Finally, both oil and natural gas prices have increased dramatically in response to the war in Iraq and uncertainty about future supplies. As a result of the higher prices, new drilling activity for oil is up substantially. Production levels are once again increasing, reversing the production declines observed during the last ten years.

The primary reasons for the change in disbursements (\$7.0 million) are as follows:

Decreased Disbursements

1. Unanticipated reversions are caused mainly by the offset of general fund appropriations in DPHHS with increased federal FMAP federal funds from the passage of the federal Jobs and Growth Tax Relief Reconciliation Act;
2. Decreased statutorily appropriated payments for debt service on bonds and TRANS, offset slightly by increased in retirement payments (see page 148 for more details);
3. Decreased non-budgeted transfers of vehicle fee revenue due to unanticipated consequences of new legislation. The decreases were offset slightly by an increased net US royalty revenue transfers (due to greater revenue) and unanticipated DPHHS program transfers (see page 151 for more details); and
4. Decreased miscellaneous appropriations caused by biennial appropriations not being fully spent in FY 2004. The continuing balances of these appropriations are included in "general appropriations".

Increased Disbursements

1. Supplemental appropriations of \$12.7 million not anticipated by the 58th legislature (see page 77, for more details);
2. Increased general appropriations due to the unspent balances of miscellaneous appropriations continuing into FY 2005; and
3. Greater expenditures than anticipated from the language appropriation allowing the Judiciary to spend reversions from the 2003 biennium.

As Figure 4 shows, the combined impact of higher revenues, reduced disbursements, and negative fund balance adjustments is a net increase in the projected fund balance of \$148.5 million for the 2005 biennium.

2007 BIENNIUM GENERAL FUND OUTLOOK

INTRODUCTION

The state's financial picture is probably the most optimistic budget situation the state has faced in a number of years. Not only are anticipated revenues significantly above the level of funding needed to fund "present law" services, the projected ending fund balance for the current biennium is well above an ending fund balance reserve advocated by national experts. Because this balance is so high, the legislature should consider using these funds for one-time initiatives and not for policies that will require additional funding in subsequent biennia.

However, large federal deficits, school funding litigation, labor negotiations, rising health care costs, and national economic uncertainties could be significant budget "busters". With the prospect of further federal tax reform, the continued threat of terrorism attacks, and the on-going US war with Iraq makes the job of developing prudent revenue estimates an extremely difficult task. Artificially low estimates may cause the legislature to reduce or restrain state services that fall below the legislature's priority line. Estimates that are too high may create the temptation for the legislature to fund state services that the state cannot afford. Obviously, the last scenario would result in spending reductions by the executive and/or a special session.

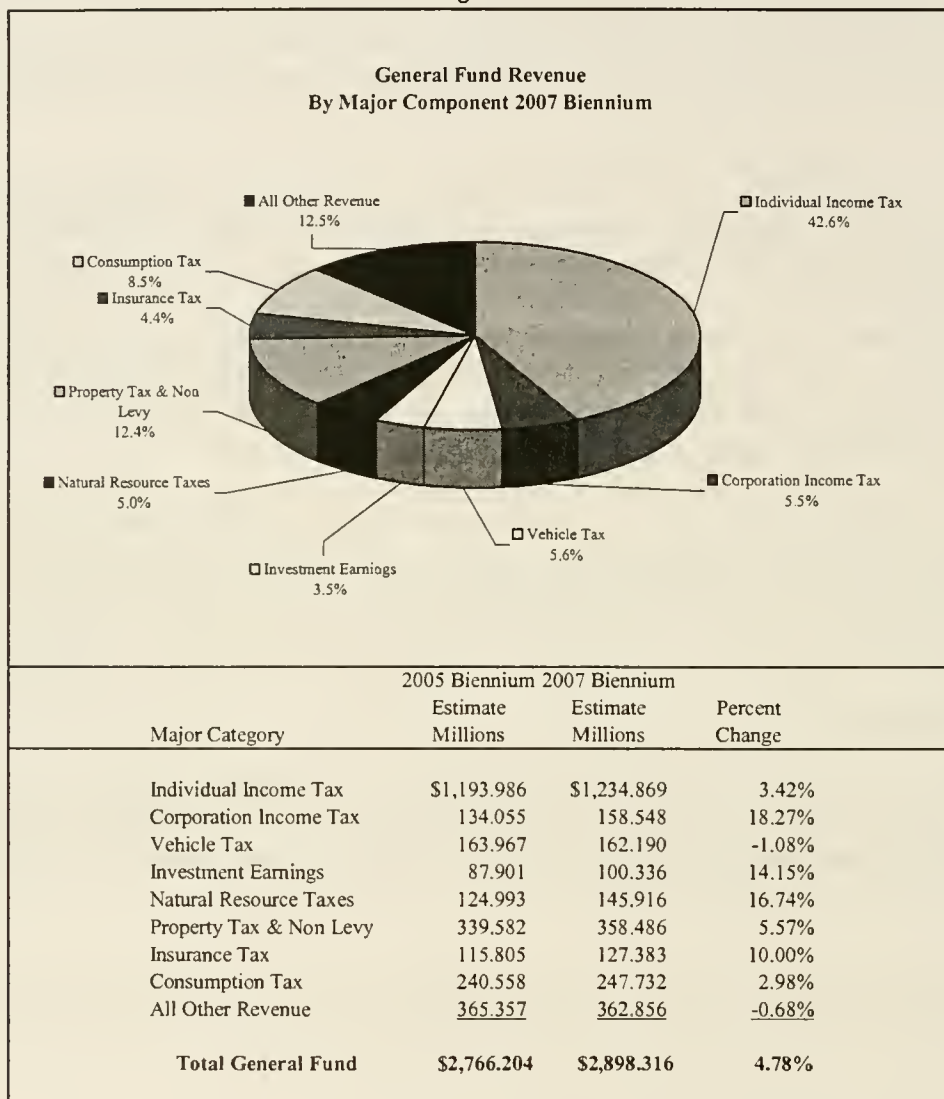
As delineated in Section 5-18-107(1) (a), MCA, the Revenue and Transportation Interim Committee (RTIC) is required to prepare "an estimate of the amount of revenue projected to be available for legislative appropriation." In addition, sections 5-12-302(2) and 5-12-307(7) specifically require the Legislative Fiscal Analyst (LFA) to "estimate revenue from existing and proposed taxes" and also requires the LFA to "assist the revenue and transportation committee in performing its revenue estimating duties..."

The next section of the report highlights the significant economic assumptions used by the RTIC to develop the revenue estimate recommendations contained in HJR 2, the revenue estimate resolution. Each assumption is discussed and is graphically portrayed to give the reader a perspective of the historical trend versus the forecast amount.

GENERAL FUND REVENUE IMPLICATIONS

Montana's fiscal outlook for revenue growth is more optimistic than in previous biennia. The key economic assumptions targeted as most affecting state government receipts are Montana total income, employment, and population levels, inflation rates, corporate profits, property values, interest rates, and energy prices.

Figure 6



As shown in Figure 6 above, individual income tax, corporation income tax, property tax, vehicle tax, and investment earnings are expected to contribute almost 70 percent to the total general fund revenue stream during the 2007 biennium. Total general fund revenues for the 2007 biennium are projected to increase 4.8 percent over the 2005 biennium projections. The comparative change by major revenue category is shown at the bottom of the figure.

Montana Total Income

The total of all income sources listed on the Montana personal income tax form is referred to as Montana total income. The Department of Revenue tracks income from 11 different components, including wages, interest, dividends, business, capital gains, supplemental, rental, farm, social security, IRA and pension, and other incomes. Montana total income is the single most important variable to consider in the revenue estimation process. Of the 11 income items, wage and salary income provides the largest portion of Montana total income. Since 1990, wage and salary income has contributed an annual average of 65.2 percent of total income. In calendar 2003, it contributed 67.6 percent, or \$9.650 billion. The average compounded growth from calendar 1990 to 2003 has been 5.6 percent.

Figure 7

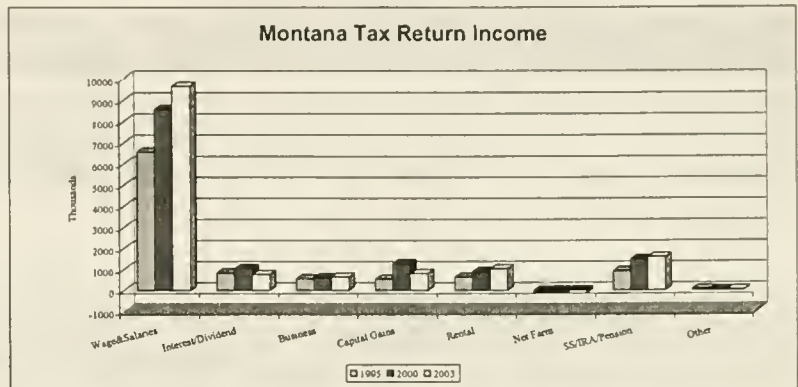
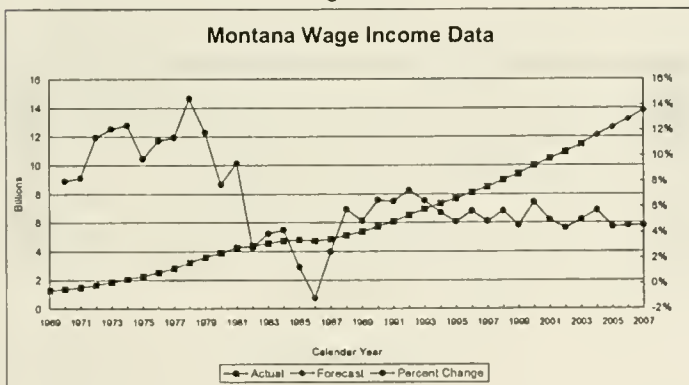
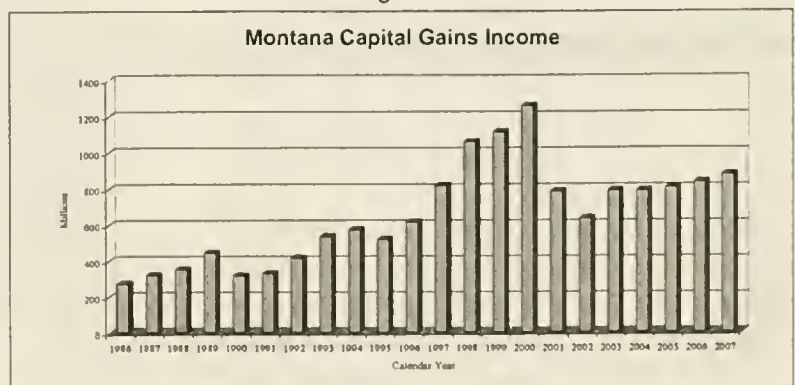


Figure 8



In recent times, capital gains income has been the focus of much conversation and speculation. Capital gains income has increased in relative importance over the decade. In 1990, capital gains made up only 4.2 percent of total income, with reported income of \$318 million. In 2001, capital gains receded to 5.7 percent of total income, with income at \$786 million, a reduction of over 37.6 percent over the previous year. In 2003, capital gains income was \$791 million and continues to represent nearly 5.5 percent of total income.

Figure 9



In 2002 capital gains income fell by \$622.3 million, but over the next four years it is expected to return to a more normal growth pattern. Capital gains is projected to increase by 11.1 percent between 2004 and 2007, a compound growth rate of 2.7 percent annually.

Montana Wages

The average annual growth in Montana wages and salaries has been 5.5 percent between 1990 and 2003. Lower wage growth has been experienced in the latter half (5.1 percent) of this period than in first half (5.8 percent). This is due to lower growth in employment and lower inflation since 1997. Somewhat countervailing these trends has been an increase in real wage per worker since 1997. The average annual growth in real wage per worker was -0.2 percent between 1990 and 1997, but has averaged 1.3 percent since then. It appears that growth in real wage per worker may reach 1.7 percent in calendar 2004.

Figure 10

Wage and Salary Income Growth					
Calendar Year	Employment Growth	Inflation	Real		Wages Growth
			Wage Per Worker		
A 1991	2.2%	4.2%	-0.1%		6.4%
A 1992	4.2%	3.0%	-0.1%		7.3%
A 1993	2.9%	3.0%	0.5%		6.5%
A 1994	4.5%	2.6%	-1.5%		5.5%
A 1995	3.1%	2.8%	-1.1%		4.8%
A 1996	2.7%	3.0%	-0.1%		5.6%
A 1997	1.3%	2.3%	1.2%		4.8%
A 1998	2.2%	1.6%	1.8%		5.7%
A 1999	1.9%	2.2%	0.3%		4.5%
A 2000	1.9%	3.4%	0.9%		6.3%
A 2001	1.1%	2.8%	1.0%		4.9%
A 2002	1.1%	1.6%	1.6%		4.3%
A 2003	1.0%	2.3%	1.6%		5.0%
F 2004	1.2%	2.7%	1.7%		5.7%
F 2005	1.2%	2.2%	1.0%		4.4%
F 2006	1.3%	2.2%	1.0%		4.5%
F 2007	1.3%	2.2%	1.0%		4.5%

The forecast for inflation between calendar years 2003 and 2007 is the same as used by the Congressional Budget Office for the federal budget. Employment is expected to grow at 1.2 percent in calendar years 2004 and 2005, and then 1.3 percent in calendar years 2006 and 2007.

The growth in real wage per worker is forecast to decline to 1 percent per year in calendar years 2005 through 2007 from its current high levels, above the long run average, but below levels seen recently.

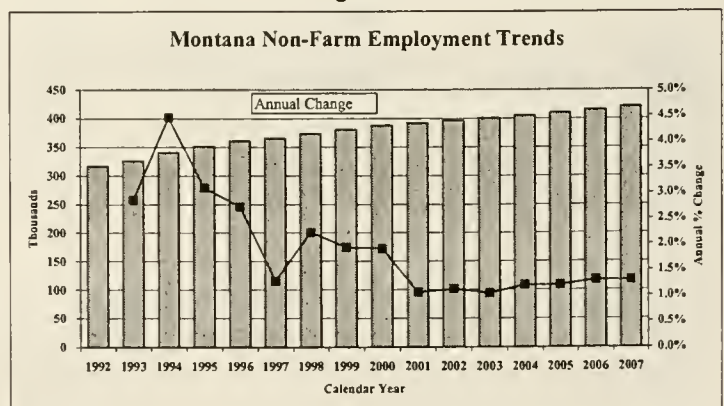
The growth in wages and salaries, unadjusted for inflation, is expected to grow by 5.7 percent in calendar 2004. First half growth in calendar 2004 was 6.0 percent, but second half growth is usually lower than first half growth when first half growth exceeds the long run average.

The growth in wages and salaries is expected to be 4.4 percent in calendar year 2005, and 4.5 percent in calendar years 2006 and 2007.

Montana Employment

Average annual growth in total employment between 1990 and 2003 has been 2.1 percent, although since 2000 the average rate of growth has been 1.1 percent. The growth in 2004 through September is 1.2 percent. It is expected that employment growth through 2005 will remain at 1.2 percent and grow by 1.3 percent in calendar years 2006 and 2007. Since 1990, the fastest growing sector in terms of employment has been construction, which experienced a 125 percent increase in employment. Other fast growing sectors have been professional and business services (115 percent growth), education and health services (53 percent growth), accommodation and food services (46 percent growth). Sectors that have experienced reduced employment since 1990 are mining (-13 percent growth, although growth has been positive in 2004), and manufacturing (-4 percent growth).

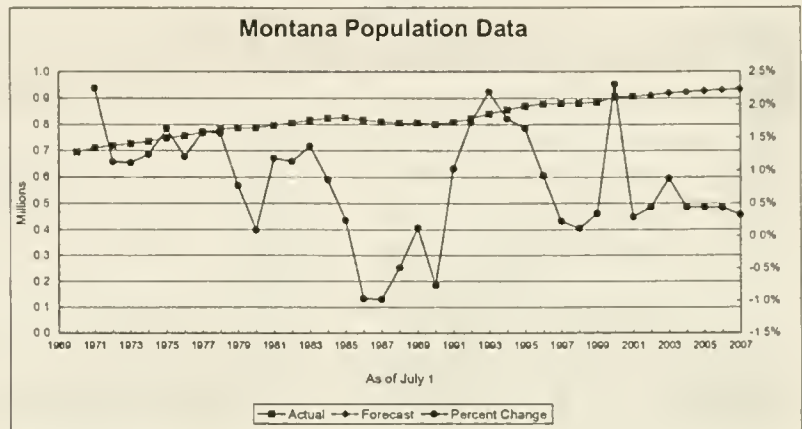
Figure 11



Montana Population

Population statistics are used to develop estimates for many of the revenue sources including beer, wine, liquor, and cigarette taxes. In addition to those sources where population has a direct effect, the size of the population indirectly affects the profitability of all businesses and the employment levels statewide. Accurate population estimates are especially important when determining the changes expected in overall and per capita income for the state.

Figure 12

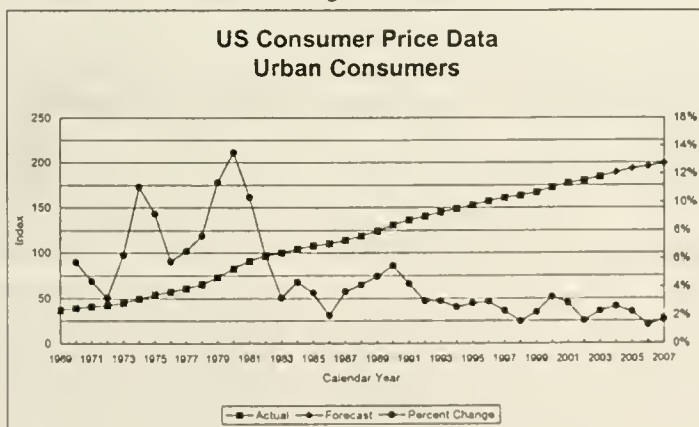


Consumption of any given item is highly reliant upon the size of the population, so accurate population forecasts are essential when determining tax revenues from the sources mentioned above. Historic population data is gathered from the U.S. Census department while projections are obtained from Global Insight. Since the early 1990's, Montana has experienced positive growth in total population varying between 0.1 percent in 1998 to 2.3 percent in 2000. Growth through the next biennium is estimated at 0.4 percent annually.

Inflation Rates

The inflation rate is measured by the price change of the Consumer Price Index (CPI) "shopping basket" of goods and services. Inflation is noted to have both good and bad effects. As prices rise, businesses increase prices and tend to become more profitable. At the same time, the consumer realizes a reduction in disposable income and spends less. Several areas where this information is vital in determining costs include minerals, timber, energy resources, and most services.

Figure 13



Since Montana's individual income tax structure is fully indexed by changes in the consumer price index, this assumption is critical in the formulation of the individual income tax forecasts. The U.S. Bureau of Labor Statistics provides the required CPI data for the all-urban customers data set. Since 1990, the average annual rate of inflation has been 2.67 percent. Global Insights forecasts inflation at 2.27 percent (November 2004). The average forecast used by the Congressional Budget Office and other private economists is 2.2 percent

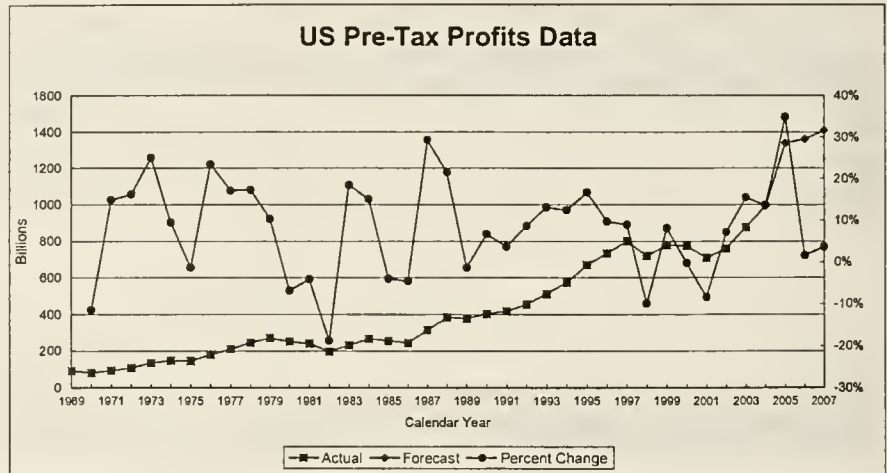
per year through calendar 2007. RTIC forecast is 2.2 percent through 2007.

Corporate Profits

The profitability of corporate America is an important factor in estimating revenues. Corporate profitability effects both corporation license tax and individual income tax estimates. When corporations are profitable nationally, there is an expectation that corporations will be profitable in Montana. Additionally, greater corporate profitability is largely responsible for the amount of dividends corporations pay to stockholders as well as the value of equity investments.

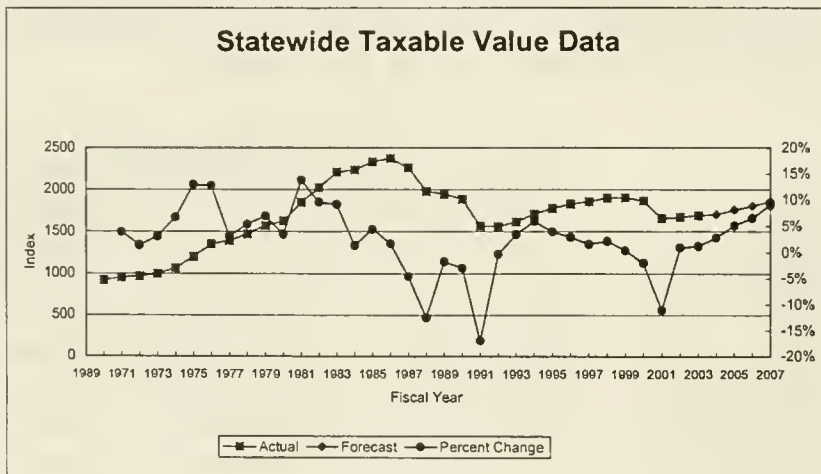
During the most recent years, the reduction of corporate profits has translated to lower corporate license tax collections. According to Global Insight, between 1990 and 1997, US corporation pre-tax profits increased by an annual average of 9.9 percent. However, from 1998 through 2001, profits have decreased by an average of 2.7 percent, the greatest decrease of 8.5 percent occurring in 2001. In 2002 and 2003, corporate profitability increased by 7.1 percent and 15.4 percent respectively, and that trend is expected to continue with projected annual increases of 13.5 percent, 34.8 percent, 1.5 percent, and 3.6 percent between 2004 and 2007 respectively.

Figure 14



Property Values

Figure 15

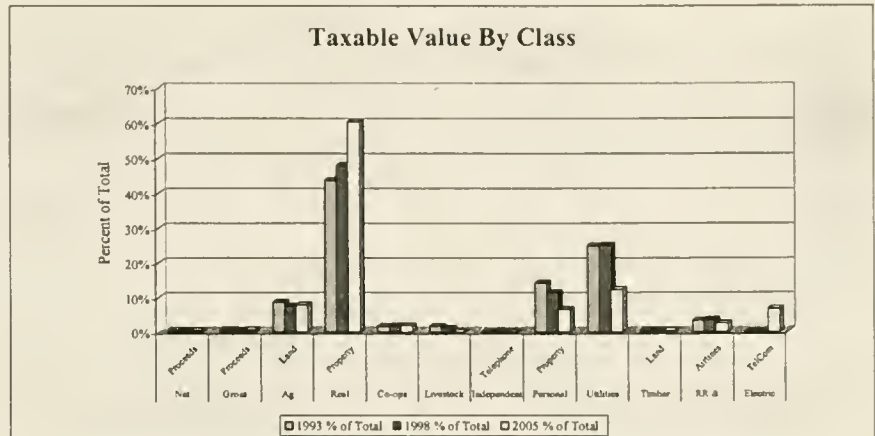


Change in statewide property values is the critical assumption behind the estimates for property taxes. Historic property values are obtained from the Montana Department of Revenue. Total statewide taxable value increased slowly during the first part of the 1990's, but fell in both fiscal 2000 and 2001. This decline was primarily due to business equipment tax changes enacted by previous legislatures. Other reductions occurred in electrical generating and telecommunication

property. Property values resumed an upward trend in 2003, and that trend is expected to continue through the next biennium. However, net taxable value growth in tax year 2006 is expected to be near 10 percent as several tax increment financing districts are eliminated.

Significant changes have taken place in statewide property values since fiscal 1998. In that year, 48.5 percent of total statewide value was in class 4, residential and commercial property, and 11.6 percent of total value was in class 8, business equipment personal property. In fiscal 2005, the class 4 taxable value is expected to make up 61.5 percent of the total property tax base, while class 8 will be only 6.7 percent of the base.

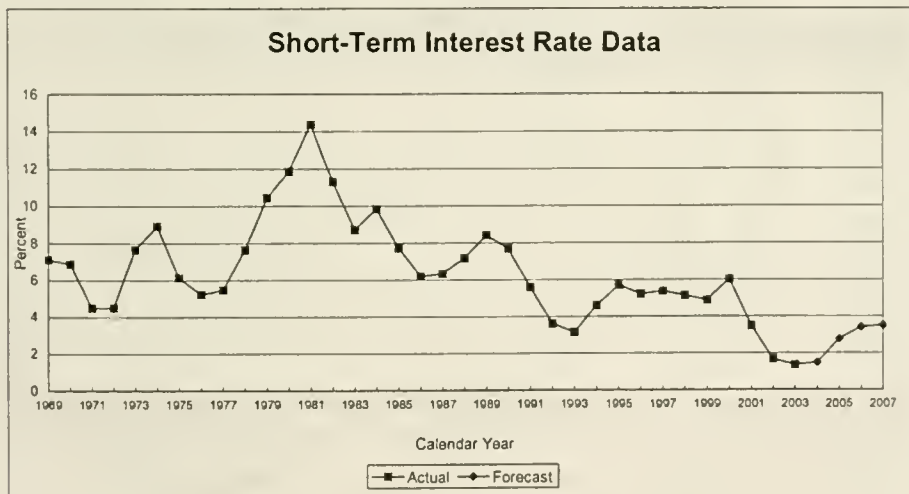
Figure 16



Interest Rates

A large portion of Montana's revenues is derived from investment earnings from trust accounts and daily cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. As such, interest rates are a significant assumption when estimating future state revenues.

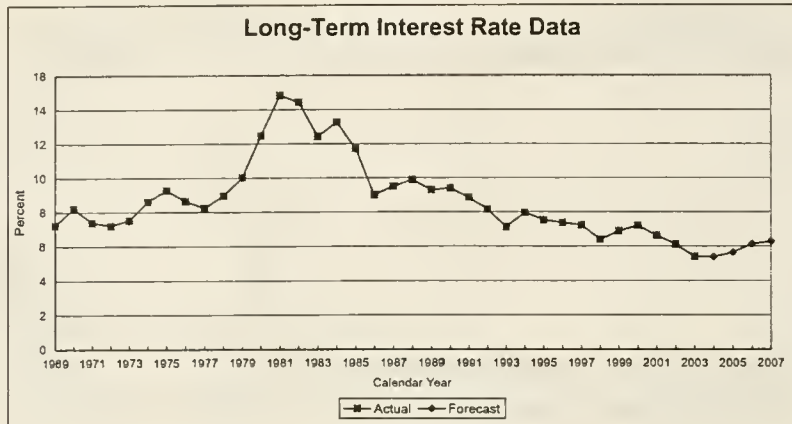
Figure 17



In addition to the state revenue impact, interest rates are fundamental in understanding the climate in which consumers and businesses are likely to make investments and large purchases. While low interest rates produce less revenue for Montana's trust and interest holdings, higher income tax earnings might be expected as construction and sales activities increase. Two types of interest rates, long and short term, are

estimated and used in determining future revenues. Both rates are an average across a selection of investment instruments. The forecasted rates are obtained from Global Insight. Long-term rates are an average of Corporate Aaa and Baa bonds, 10-year T bonds, and 30-year T bonds. Short-term rates are an average of 3 and 6-month Corporate paper and 3 and 6 month T-bills. The fiscal year computation of both long and short-term interest rates reached an unprecedented low in 2004. However, as the economy began to regain strength in calendar year 2004, the Federal Reserve began increasing the discount rate. Global Insight projects that interest rates will increase through the 2007 biennium, and their projection is made credible by the fact that the Federal Reserve raised interest rates again in November and December 2004.

Figure 18

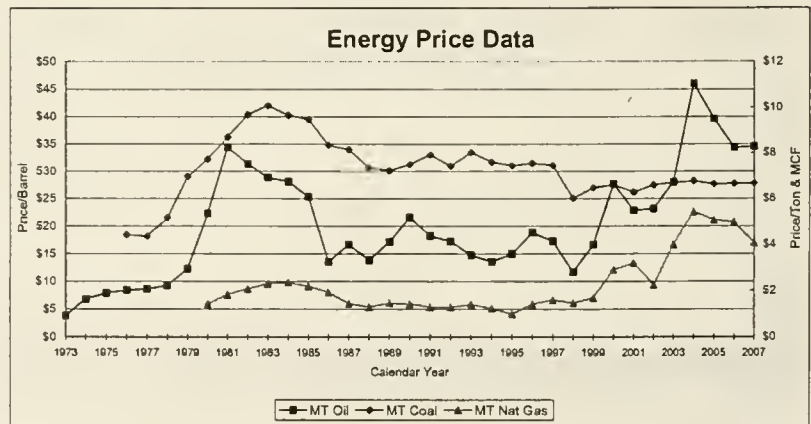


Energy Prices and Consumption

West Texas Intermediate (WTI) spot oil prices averaged \$26.18 in calendar 2002, rose to \$31.00 in calendar 2003, and have averaged \$41.00 in calendar 2004. Global Insights forecasts WTI oil prices to increase to \$46.13 in calendar 2005, and then drop to \$36.21 in calendar 2006 with a further drop to \$34.85 in calendar 2007. Montana wellhead prices will be \$3 dollar below these prices.

Natural gas prices at the wellhead in the US averaged \$3 per million cubic feet in calendar 2002, rose to \$5 in calendar 2003, and have averaged \$5.40 in calendar 2004. The New York Mercantile Exchange is forecasting average Henry Hub natural gas prices at \$7.15 in calendar 2005, \$6.68 in calendar 2006, and \$4.11 in calendar 2007. Montana wellhead prices are \$2 less than these prices.

Figure 19



After decades long reductions in oil production – from a peak in 1973 of 34 million barrels to a trough in 1999 of 15 million barrels – recent Montana production has increased. New drilling activity increased 75 percent in 2003, and has increased nearly the same amount in 2004, in response to high prices. In calendar 2003 production was over 19 million barrels and will probably be near 22 million barrels in calendar 2004. Montana oil production is expected to continue to increase to just over 25 million barrels in calendar 2005, just under 28 million barrels in calendar 2006, and to 30 million barrels in calendar 2007.

Natural gas production in Montana doubled between 1981 and 2003, from 40 million MCF to 80 million MCF, with 75 percent of that increase since 1997, in response to higher prices. Newly drilled wells have contributed around 20 percent to total production since calendar 2000. As in the oil market, new drilling activity was up substantially in calendar 2003 and 2004. Montana natural gas production is

expected to rise to 89 million MCF in calendar 2004, 95.2 million MCF in calendar 2005, 101 million MCF in calendar 2005, and 106 million in calendar 2007.

GENERAL FUND REVENUE ESTIMATES

Figures 20 and 21 show the RTIC general fund and non-general fund revenue recommendations for fiscal years 2005, 2006, and 2007. These recommendations are based on the major assumptions as discussed previously.

It should be noted that the RTIC discussed two issues that have significant impacts on state revenue estimates: Initiative 149 cigarette and tobacco tax impacts, and market share losses by participating cigarette manufacturers in the tobacco settlement agreement.

Figure 20

Legislative Fiscal Division Recommendations General Fund Revenue Estimates In Millions								
Source of Revenue	Percent of 2004	Actual Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated Fiscal 04-05	Estimated Fiscal 06-07	Cumulative % of Total
Individual Income Tax	43.82%	\$605.348	\$588.638	\$605.029	\$629.840	\$1,193.986	\$1,234.869	42.61%
Property Tax	12.27%	169.531	170.051	175.823	182.663	339.582	358.486	54.98%
Corporation Income Tax	4.90%	67.723	66.332	80.621	77.927	134.055	158.548	60.45%
Vehicle Tax	6.05%	83.607	80.360	80.140	82.050	163.967	162.190	66.04%
Common School Interest and Income	0.00%	-	-	-	-	-	-	66.04%
Insurance Tax & License Fees	4.09%	56.533	59.272	62.163	65.220	115.805	127.383	70.44%
Coal Trust Interest	2.53%	34.907	35.999	36.790	37.244	70.906	74.034	72.99%
US Mineral Royalty	2.08%	28.736	35.837	34.660	35.334	64.573	69.994	75.41%
All Other Revenue	2.19%	30.242	28.304	24.734	24.923	58.546	49.657	77.12%
Tobacco Settlement	0.21%	2.934	2.871	2.319	2.309	5.805	4.628	77.28%
Telecommunications Excise Tax	1.51%	20.890	21.307	21.700	22.101	42.197	43.801	78.79%
Video Gambling Tax	3.67%	50.749	52.932	55.304	57.782	103.681	113.086	82.69%
Treasury Cash Account Interest	0.46%	6.393	10.602	13.287	13.015	16.995	26.302	83.60%
Estate Tax	0.83%	11.431	3.701	1.950	0.939	15.132	2.889	83.70%
Oil & Natural Gas Production Tax	2.99%	41.324	58.206	58.498	59.057	99.530	117.555	87.76%
Motor Vehicle Fee	2.22%	30.724	31.730	36.770	37.819	62.454	74.589	90.33%
Public Institution Reimbursements	1.31%	18.110	16.032	14.900	14.900	34.142	29.800	91.36%
Lodging Facility Use Tax	0.67%	9.279	10.113	10.715	11.419	19.392	22.134	92.12%
Coal Severance Tax	0.63%	8.643	9.105	8.659	8.841	17.748	17.500	92.72%
Liquor Excise & License Tax	0.78%	10.718	11.125	11.535	11.959	21.843	23.494	93.53%
Cigarette Tax	2.61%	36.002	34.608	33.193	32.030	70.610	65.223	95.79%
Investment License Fee	0.35%	4.834	4.464	4.598	4.736	9.298	9.334	96.11%
Lottery Profits	0.59%	8.116	7.273	7.288	7.953	15.389	15.241	96.63%
Liquor Profits	0.47%	6.500	6.608	6.854	7.158	13.108	14.012	97.12%
Nursing Facilities Fee	0.43%	5.916	5.833	5.793	5.757	11.749	11.550	97.52%
Foreign Capital Depository Tax	0.00%	-	-	-	-	-	-	97.52%
Electrical Energy Tax	0.34%	4.661	4.295	4.276	4.270	8.956	8.546	97.81%
Metalliferous Mines Tax	0.23%	3.232	4.483	5.328	5.533	7.715	10.861	98.18%
Highway Patrol Fines	0.30%	4.084	4.104	4.125	4.143	8.188	8.268	98.47%
Public Contractors Tax	0.15%	2.120	1.748	3.030	2.872	3.868	5.902	98.67%
Wholesale Energy Tax	0.24%	3.293	3.485	3.520	3.555	6.778	7.075	98.92%
Tobacco Tax	0.26%	3.562	3.677	3.779	3.847	7.239	7.626	99.18%
Driver's License Fee	0.22%	3.021	2.997	3.011	3.018	6.018	6.029	99.39%
Rental Car Sales Tax	0.18%	2.486	2.593	2.704	2.820	5.079	5.524	99.58%
Railroad Car Tax	0.11%	1.568	1.585	1.574	1.562	3.153	3.136	99.69%
Wine Tax	0.10%	1.423	1.436	1.487	1.538	2.859	3.025	99.79%
Beer Tax	0.21%	2.897	2.933	2.986	3.039	5.830	6.025	100.00%
Telephone License Tax	0.00%	0.029	-	-	-	0.029	-	100.00%
Long Range Bond Excess	0.00%	-	-	-	-	-	-	100.00%
Total General Fund	100.00%	\$1,381.565	\$1,384.639	\$1,429.143	\$1,469.173	\$2,766.204	\$2,898.316	100.00%

Figure 21

Legislative Fiscal Division Recommendations Non-General Fund Revenue Estimates In Millions								
Source of Revenue	Percent of 2004	Actual Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated Fiscal 04-05	Estimated Fiscal 06-07	Cumulative % of Total
1 Diesel Tax	17.98%	\$63.181	\$65.819	\$68.567	\$71.430	\$129.000	\$139.997	18.93%
2 Federal Forest Receipts	3.55%	12.491	12.654	12.795	12.878	25.145	25.673	22.40%
3 Gasoline Tax	37.83%	132.962	133.577	134.177	134.774	266.539	268.951	58.77%
4 GVW and Other Fees	7.82%	27.500	27.896	28.287	28.732	55.396	57.019	66.48%
5 Lodging Facility Use Tax	6.50%	22.848	24.159	25.597	27.278	47.007	52.875	73.63%
6 Resource Indemnity Tax	0.36%	1.251	1.229	1.176	1.323	2.480	2.499	73.97%
7 Arts Trust Interest	0.09%	0.326	0.338	0.351	0.364	0.664	0.715	74.06%
8 Capital Land Grant Interest and Income	0.69%	2.413	0.820	0.939	0.943	3.233	1.882	74.32%
9 Deaf & Blind Interest and Income	0.09%	0.299	0.304	0.305	0.306	0.603	0.611	74.40%
10 Parks Trust Interest	0.32%	1.140	1.163	1.191	1.217	2.303	2.408	74.72%
11 Pine Hills Interest and Income	0.11%	0.394	0.388	0.388	0.389	0.782	0.777	74.83%
12 RIT Trust Interest	2.10%	7.380	7.401	7.417	7.420	14.781	14.837	76.84%
13 TSE Trust Interest	2.38%	8.349	9.094	9.704	10.230	17.443	19.934	79.53%
14 Property Tax: 6 Mill	3.24%	11.374	10.704	10.983	11.278	22.078	22.261	82.54%
15 Property Tax: 9 Mill	0.00%	-	-	-	-	-	-	82.54%
16 Tobacco Trust Interest	0.76%	2.670	3.123	3.709	4.230	5.793	7.939	83.61%
17 Regional Water Trust Interest	0.34%	1.201	1.487	1.757	2.007	2.688	3.764	84.12%
18 Common School Interest and Income	15.84%	55.663	60.373	59.307	58.106	116.036	117.413	100.00%
Total Non-General Fund	100.00%	\$351.442	\$360.529	\$366.650	\$372.905	\$711.971	\$739.555	100.00%

2007 BIENNIUM PROJECTION

Figure 22 shows the projected present law general fund balance for the 2007 biennium. Amounts shown include the revenue estimates as adopted by RTIC on November 16, 2004, and the cost of operating state government based on present law requirements. These disbursement amounts are as proposed in the executive budget. The present law amounts shown for both anticipated revenues and expenditures do not include any new proposals or initiatives recommended by the executive.

As Figure 22 shows, the 2007 biennium ending general fund balance is projected to be a positive \$293.3 million before any new proposals or initiatives are considered. This balance indicates the state can maintain the existing present level of services without a reduction in services or revenue enhancements.

Figure 22

2007 Biennium General Fund Balance Present Law Only (In Millions)			
	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated 2007 Biennium
Beginning Fund Balance	\$194.725	\$227.012	\$194.725
Revenues			
Current Law Revenue	<u>1,429.143</u>	<u>1,469.173</u>	<u>2,898.316</u>
Total Funds Available	\$1,623.868	\$1,696.185	\$3,093.041
Disbursements			
General Appropriations			
Human Services	293.317	305.061	598.378
Corrections	115.883	117.306	233.189
Higher Education	145.294	145.207	290.501
Public Schools	522.799	528.250	1,051.049
Other Agencies	165.864	146.582	312.446
Statutory Appropriations	133.085	135.606	268.691
Non-Budgeted Transfers	20.917	20.314	41.231
Feed Bill Appropriations	2.100	8.050	10.150
Anticipated Reversions	(2.403)	(3.452)	(5.855)
Total Disbursements	\$1,396.856	\$1,402.924	\$2,799.780
Ending Fund Balance Before Reserve	\$227.012	\$293.261	\$293.261
Proposed Executive Budget Reserve	(\$80.000)	(\$80.000)	(\$80.000)
Projected Present Law Surplus	\$147.012	\$213.261	\$213.261

**LFD
ISSUE**

Although the executive is requesting supplemental appropriations of \$12.7 million for fiscal 2005, their fund balance statement for the 2007 biennium does not include any anticipated supplemental or emergency appropriations. Supplemental and emergency appropriations have never been less than \$11.5 million for the last 10 biennia. In addition, state statute authorizes \$165.5 million statutory appropriation for emergencies.

Figure 23

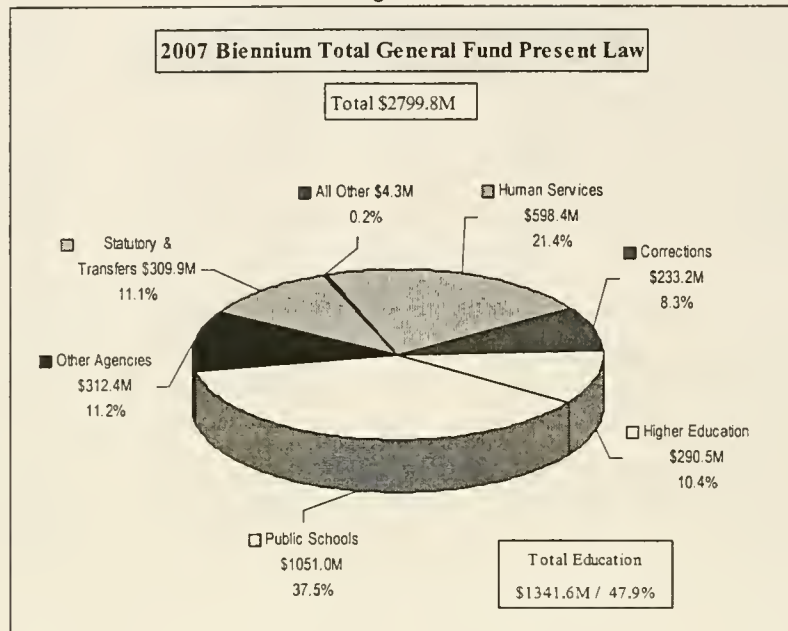


Figure 23 shows the allocation of general fund dollars to functional areas, provided the funds are available to fund present law costs. As the chart indicates, educational services consume almost 48 percent of total general fund expenditures, with human service and correctional services expending nearly 30 percent. All other governmental agencies expend almost 11 percent, with the remaining 11 percent expended by statutory appropriations for debt service, retirement systems, local government reimbursements and transfers. For more information on statutory appropriations and non-budgeted transfers, see pages 148 and 151.

Figure 24 on the following page shows the projected general fund balance with the executive new proposals and initiatives included. The executive new proposals are categorized as either a revenue or disbursement proposal. Since the present law budget is positive, the total budget initiatives for all of the executive new proposals is a negative \$112.0 million. This amount, combined with the available present law balance, results in an ending balance of \$181.3 million. When the executive's recommended ending fund balance reserve of \$80.0 million is included, a difference of \$101.3 million is created. In other words, if the entire executive budget (present law plus all initiatives) is funded, there is still \$101.3 million available for legislative consideration.

Figure 24

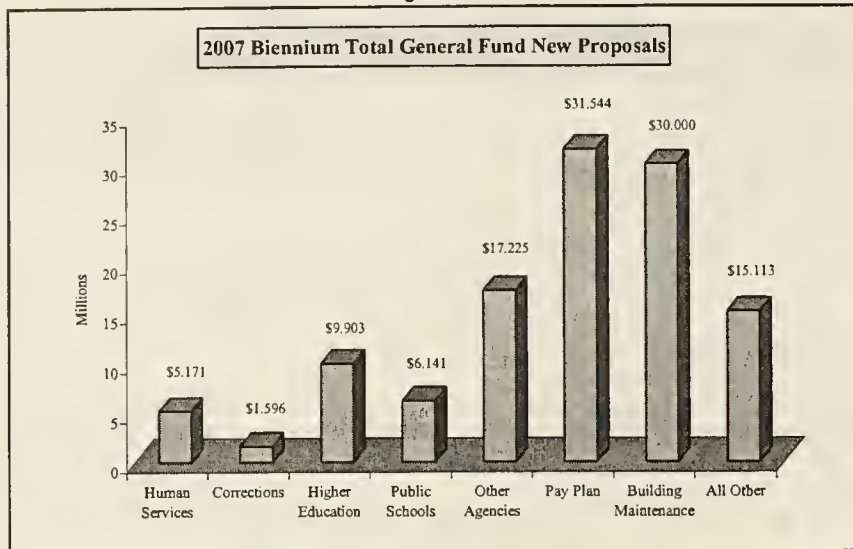
2007 Biennium General Fund Balance With Executive Budget New Proposals (In Millions)			
	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated 2007 Biennium
Beginning Present Law Balance	\$293.261	\$240.209	\$293.261
Executive Revenue Proposals			
Department of Revenue Loan Payback	2.774	3.183	5.957
Department of Justice Pathologist	<u>0.158</u>	<u>0.159</u>	<u>0.317</u>
Total Revenue Proposals	\$2.932	\$3.342	\$6.274
Executive Disbursement Proposals			
General Appropriations			
Human Services	2.864	2.307	5.171
Corrections	1.421	0.175	1.596
Higher Education	4.933	4.970	9.903
Public Schools	2.589	3.552	6.141
Other Agencies	12.269	4.956	17.225
Language Appropriations	0.887	0.705	1.592
Long Range Building	10.000	20.000	30.000
Cultural Trust Repayment	3.913		3.913
Protested Property Tax Reserve	4.000		4.000
Retirement System Funding	3.600	3.600	7.200
Executive Pay Proposal	<u>9.508</u>	<u>22.036</u>	<u>31.544</u>
Total Disbursement Proposals	\$55.984	\$62.301	\$118.285
Total Executive New Proposals	(\$53.052)	(\$58.959)	(\$112.011)
Ending Balance Before Reserve	\$240.209	\$181.250	\$181.250
Executive Proposed Ending Fund Reserve	80.000	80.000	80.000
Difference From Proposed Reserve	\$160.209	\$101.250	\$101.250

**LFD
COMMENT**

The executive budget includes phased-in proposals that will cost more in the 2009 biennium budget. This means the 2007 legislature will be faced with funding additional services above the 2007 biennium costs.

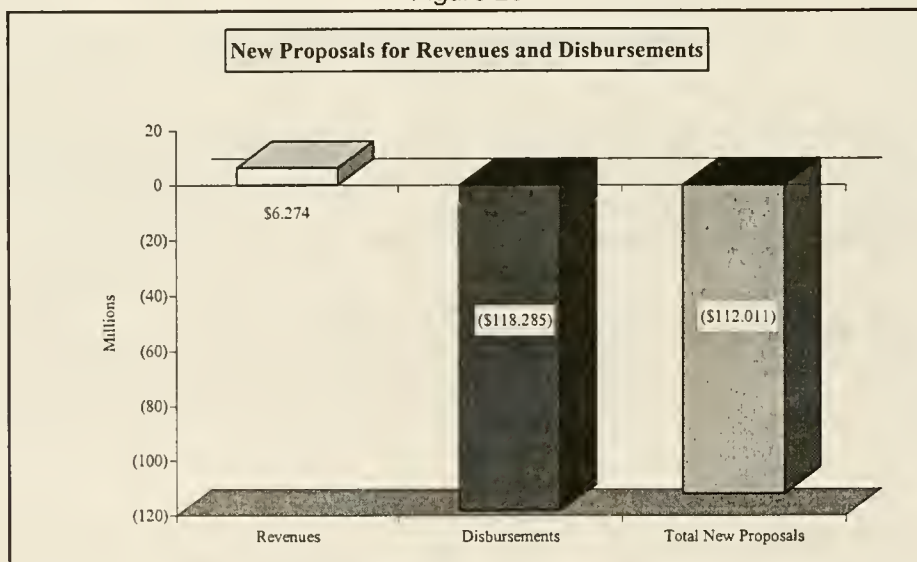
Figure 25 shows the allocation of all new proposal expenditure changes to functional areas. As the figure depicts, the executive budget allocates the largest dollar increase to a proposed pay plan and building maintenance. Human services, higher education, corrections, public education, and other governmental agencies are recommended for the least increases when compared to the other two areas.

Figure 25



The new proposal recommendations of the executive include both revenue and disbursement types. Figure 26 graphically portrays the dollar impact of these proposals. As shown in the figure, revenue initiatives are \$6.3 million and disbursement proposals are \$121.7 million for a combined impact of a negative \$112.0 million. When this amount is combined with the present law surplus of \$293.3 million, the executive budget (if adopted) would create a general fund balance of \$181.3 million or \$101.3 million above their recommended reserve of \$ 80.0 million.

Figure 26



EXECUTIVE BUDGET ONE-TIME VS ON-GOING

The executive budget proposes to use one-time general fund revenues on one-time expenditures. One-time revenue for the 2005 biennium is simply the difference between the projected ending fund balance for the 2005 biennium (\$194.7 million) and the projected ending fund balance (\$46.2 million) adopted by the 58th Legislature. This difference is \$148.5 million.

Executive Budget One-Time Only Initiatives - 2007 Biennium			
Category	Proposed FY 2006	Proposed FY 2007	Proposed 2007 Biennium
HB2 Present Law Adjustments - One-Time Only			
PL - 1 Security Equipment Replacement	55,074	0	55,074
PL - 105 Pay Off the IRIS Computer System Loan	16,000,000	0	16,000,000
PL - 106 Replace the Remainder of the POINTS System	3,000,000	1,000,000	4,000,000
PL - 2019 Database Maintenance Costs - OTO	25,000	25,000	50,000
PL - 2022 Water Quality Monitoring TMDL Completion-OTO	165,000	165,000	330,000
PL - 2102 Phone System Billings Office-OTO	0	15,000	15,000
PL - 2312 Crow Tribe Settlement - OTO	4,500,000	4,500,000	9,000,000
PL - 3 Enhancement of GCD Database and Business Processes	1,100,000	0	1,100,000
PL - 3 License Plate Re-Issue	3,853,751	496,837	4,350,588
PL - 3506 Build additional UH-1 Helicopter-OTO	200,000	0	200,000
PL - 7000 Computer Server Replacement -	<u>10,000</u>	<u>10,000</u>	<u>20,000</u>
Total HB2 Present Law Adjustments - One-Time Only	\$28,908,825	\$6,211,837	\$35,120,662
HB2 New Proposals - One-Time Only			
NP - 1 Offender Tracking System - Restricted/OTO	1,421,098	174,574	1,595,672
NP - 3 E-Grants and Data Base System	5,000	5,000	10,000
NP - 4 Workload Assessment Study - OTO	75,000	0	75,000
NP - 40 Business & Econ. Dev Outreach - OTO	180,000	180,000	360,000
NP - 5 Purchase Software Licenses - OTO	1,345,000	0	1,345,000
NP - 51 Distant Learning Initiative -OTO	500,000	500,000	1,000,000
NP - 54 Audiology equipment - Restricted/OTO	85,000	85,000	170,000
NP - 60 2-Yr Education-Develop Common Curriculum	600,000	600,000	1,200,000
NP - 61 MT Tech Economic Development Resource Center -OTO	50,000	50,000	100,000
NP - 63 Increase Supply of Health Care Workers - OTO	500,000	500,000	1,000,000
NP - 7001 Additional Grant Money for Loss of C&A Interest	40,000	0	40,000
NP - 7002 Computer Equipment Upgrade	70,000	0	70,000
NP - 722 Emergency Telecommunications Infrastructure - OTO	4,100,000	0	4,100,000
NP - 77 Workforce System Data Collection and Mang. -OTO	140,000	140,000	280,000
NP - 78 Equipment - 2 Year Programs - OTO	2,500,000	2,500,000	5,000,000
NP - 804 Property Tax Computer System	2,750,000	2,750,000	5,500,000
NP - 805 Agricultural/Forest Land Classification System	<u>1,400,000</u>	<u>0</u>	<u>1,400,000</u>
Total HB2 New Proposals - One-Time Only	\$15,761,098	\$7,484,574	\$23,245,672
Total HB2 Present Law & New Proposals - One-Time Only	\$44,669,923	\$13,696,411	\$58,366,334
Other New Initiatives - One-Time Only			
Long Range Building	10,000,000	20,000,000	30,000,000
Cultural Trust Repayment	3,913,000	0	3,913,000
Protested Property Tax Reserve	4,000,000	0	4,000,000
Transfer to Federal Government for State Fund Payout	<u>224,461</u>	<u>0</u>	<u>224,461</u>
Total Other New Initiatives - One-Time Only	\$18,137,461	\$20,000,000	\$38,137,461
Total All Expenditure Initiatives - One-Time Only	\$62,807,384	\$33,696,411	\$96,503,795
Increase Ending Fund Balance to \$80 Million			33,800,000
Grand Total One-Time Only Initiatives	\$62,807,384	\$33,696,411	\$130,303,795

Figure 27

As Figure 27 shows, the executive budget proposes using \$96.5 million of this one-time revenue for one-time expenditure initiatives during the 2007 biennium. Figure 27 also shows the recommended one-time expenditures by three categories, "HB2 Present Law Adjustments", "HB2 New Proposals" and "Other New Initiatives". As stated in the executive budget "The goal of the Governor was to provide a lasting impact with the excess fund balance available."

To summarize the detail shown in Figure 27, these initiatives can be more appropriately categorized as: 1) paying off debts; 2) addressing infrastructure needs; 3) investing in information technology; 4) preparing for the future; 5) improving services by addressing equipment needs; and 6) augmenting the ending fund balance. As shown in Figure 28, over 71 percent of the one-time proposals will be used for “paying of debts”, “deferred maintenance projects”, and augmenting the ending fund balance. If the 59th Legislature accepts all of these recommendations, the legislature will still have \$18.2 million of one-time revenue for legislative consideration. These remaining one-time revenues could be used for other legislative initiatives (revenue and/or expenditure), creating a rainy day fund, or increasing the ending fund balance beyond the executive recommendation of \$80 million.

**LFD
COMMENT**

The Legislative Fiscal Division recommends the legislature consider transferring a portion of these one-time revenues to a “rainy day fund”. This fund could then be used in subsequent biennia for emergencies and/or unexpected revenue shortfalls. The Legislative Finance Committee has requested a bill draft to create a “rainy day fund”.

DIFFERENCES FROM EXECUTIVE PROPOSAL

The executive budget as submitted projects an ending fund balance of \$162.9 million after funding all executive present law adjustments and new proposals. This contrasts with Figure 24, which shows a general fund balance of \$181.3 million, or a difference of \$18.4 million. This balance is based on the RTIC revenue estimates, LFD estimates for statutory appropriations and reversions, and the executive’s recommendations for all present law adjustments and new proposals. As advocated by the LFD in the past, an adequate reserve is necessary for unexpected occurrences including emergencies, fire suppression costs, supplemental appropriations, or lower than expected revenue collections. As shown in Figure 29, there are a number of items that contribute to the total difference of \$18.4 million. Each of these differences is explained in the next section.

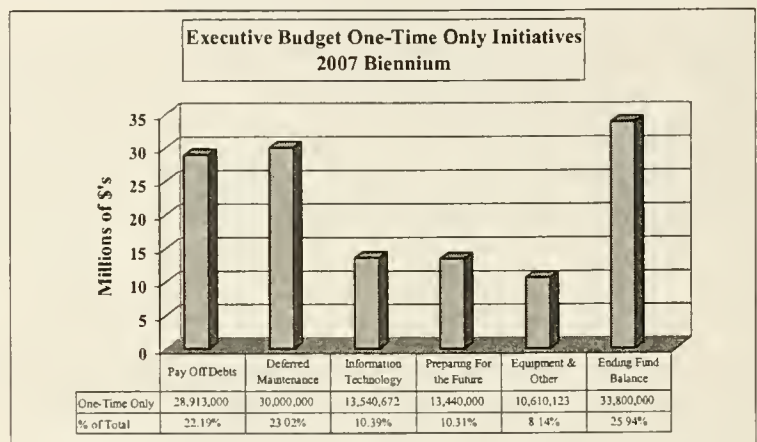


Figure 28

Explanation of Differences

Beginning FY 2005 Fund Balance – The fund balance at the end of FY 2004 decreases by \$2.4 million due to Comprehensive Annual Financial Report adjustments recommended by the Legislative Audit Division. The primary adjustments are: 1) a reduction of \$3.5 million in transfers of U.S. royalty revenue to the mineral impact account that was not recorded in fiscal 2004; and 2) increases totaling \$950,000 to reflect the proper value of MSTA-MUS loans and interest earnings.

General Fund Revenue - The combined differences of all general fund sources between the RTIC adopted estimates and the executive is \$14.4 million. This difference is primarily due to the committee’s inclusion of additional revenue from the cigarette and tobacco tax increases implemented by the passage of I-149 by the electorate in November 2004.

General Appropriations – The net difference between these appropriation items is \$3.2 million. Of the FY 2005 \$7.0 million legislative feed bill, the LFD anticipates \$2.1 million will be unspent and carried over to FY 2006. The remaining difference is the sum of minor differences in multiple miscellaneous appropriations.

Statutory Appropriations – The difference in this category is primarily due to the information received from agencies that administer statutory appropriations. In most instances, the executive and the LFD relied on information supplied by the respective agencies. Because the executive is required to submit the executive budget by November 15th, the LFD had more current information available. The executive also included an estimated \$199,000 that is not included in the LFD estimate, since legislation is required.

Non-Budgeted Transfers – The executive anticipates more revenue from US mineral royalties than approved by RTIC and, thus, transfers to the mineral impact account are also higher. In addition, the executive does not include an accounting change recommended in a legislative audit that reduces this transfer by \$3.5 million regarding this transfer in fiscal 2005. Because the Board of Investments will not loan any money from the INTERCAP loan program until the legislature addresses the issue of state debt, the LFD does not include \$2.1 million of transfers to pay loan costs for training primary sector businesses. The executive also includes \$1.6 million of transfers in anticipation of proposed legislation being enacted.

Summary

In summary, if the RTIC revenue estimate recommendations were adopted by the legislature, the general fund present law balance would be a positive \$293.3 million. However, since the state incurs significant wildfire costs each year, some allowance for these costs must be included in any biennium ending fund balance projection. Although the cost of fighting wildfires can fluctuate significantly from biennium to biennium, a 7 year average, removing the high and low years (FY 2004 and FY 2005, respectively), is just over \$7.0 million per year. This amount is included as a reserve in Figure 30 (\$14.1 million for the biennium) to represent anticipated fire costs in the 2007 biennium.

In addition, state statute authorizes a general fund statutory appropriation of \$16.5 million per biennium for the Governor to deal with declared disasters or emergencies such as floods, fires, and other natural disasters. From FY 2000 through FY 2003, the average expenditure (excluding fire costs already included in the fire cost average discussed above) from the emergency appropriation is nearly \$400,000 per year (\$800,00 per biennium). This amount is included as a reserve in Figure 30 to represent anticipated emergency costs in the 2007 biennium.

If the two reserves discussed above were included in the fund balance statement, the present law balance would decline to a positive \$278.3 million. A balance in the general fund of \$166.4 million would occur if the legislature adopted the executive's recommendations for all new proposals and initiatives, \$86.4 million above the executive recommended ending reserve.

Figure 29

Differences From Executive Budget Fiscal 2005, 2006, 2007 (In Millions)	
Fund Balance Category	3 Year Difference
+ Beginning Fund Balance	(\$2,377)
+ Revenues	14,405
- Disbursements	
General Appropriations	3,151
Statutory Appropriations	(0,999)
Non-Budgeted Transfers	(7,810)
Supplemental Appropriations	0,021
Anticipated Reversions	0,166
+ Fund Balance Adjustments	0,875
Total Change to Fund Balance	\$18,374

PROJECTED GENERAL FUND BALANCE

Figure 30 shows the detailed general fund balance sheet based on present law revenues and disbursements, followed by a sub-table that shows the balance when the executive's new proposals are included. The \$80.0 million reserve as proposed by the executive is not shown in this table.

2007 Biennium General Fund Balance Based on Present Law (In Millions)						
	Actual Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 2006	Estimated Fiscal 2007	Estimated 2005 Biennium	Estimated 2007 Biennium
Beginning Fund Balance	\$43.065	\$132.873	\$194.725	\$219.567	\$43.065	\$194.725
Revenues						
Current Law Revenue	1,381.565	1,384.639	1,429.143	1,469.173	2,766.204	2,898.316
Total Funds Available	\$1,424.630	\$1,517.512	\$1,623.868	\$1,688.740	\$2,809.269	\$3,093.041
Disbursements						
General Appropriations	1,161.831	1,167.626	1,243.157	1,242.405	2,329.457	2,485.562
Statutory Appropriations	126.600	128.660	133.085	135.606	255.260	268.691
Local Assistance Appropriations						
Miscellaneous Appropriations	1.866	2.385			4.251	
Non-Budgeted Transfers	10.052	17.469	20.917	20.314	27.521	41.231
Supplemental Appropriations		12.651			12.651	
Language Appropriations	1.372	0.350			1.722	
Feed Bill Appropriations		7.000	2.100	8.050	7.000	10.150
Anticipated Reversions	(19.683)	(8.979)	(2.403)	(3.452)	(28.662)	(5.855)
Total Disbursements	\$1,282.038	\$1,327.162	\$1,396.856	\$1,402.923	\$2,609.200	\$2,799.779
Adjustments	(9.719)	4.375			(5.344)	
Reserved Ending Fund Balance	\$132.873	\$194.725	\$227.012	\$285.817	\$194.725	\$293.262
Wildfire Suppression Cost Reserve			7.045	7.045		14.090
Emergency Appropriation Reserve			0.400	0.400		0.800
Unreserved Ending Fund Balance	\$132.873	\$194.725	\$219.567	\$278.372	\$194.725	\$278.372
Net Operations	\$99.527	\$57.477	\$24.842	\$58.805	\$157.004	\$83.647
New Executive Proposals Not Included Above						
Revenue Initiative			\$2.932	\$3.342		\$6.274
Disbursement New Proposals						
Long Range Building			10.000	20.000		30.000
Cultural Trust Repayment			3.913			3.913
Protested Property Tax Reserve			4.000			4.000
Retirement System Funding			3.600	3.600		7.200
Executive Pay Proposal			9.508	22.036		31.544
Language Appropriations			0.887	0.705		1.592
HB2 New Proposals			24.076	15.960		40.036
Total Disbursement Initiative			\$55.984	\$62.301		\$118.285
Potential Ending Fund Balance With Reserves			\$166.515	\$166.361	\$194.725	\$166.361

Figure 30

EXECUTIVE BUDGET ANALYSIS

LFD Statewide Summary

Budget Overview

Revenue Proposals - Summary

Expenditure Proposals - Summary

Statewide Budget Proposals/Issues

Other LFD Issues





EXECUTIVE BUDGET OVERVIEW

INTRODUCTION

This chapter is an overview of the budget submitted for the 2007 Biennium by Governor Martz, pursuant to statute. This overview provides a summary of the more detailed agency budget presentation contained in Volumes 3 and 4 of the Legislative Budget Analysis, as well as statewide issues such as the pay plan. It is intended to provide the reader with a general understanding of the major components and priorities of the Martz budget. This and subsequent sections of this chapter include the following:

- Budget comparisons with the previous biennium
- Executive revenue proposals summary
- Executive expenditure proposals summary
- Statewide budget proposals and issues
- Other executive budget issues identified through Legislative Fiscal Division analysis

A number of relatively minor amendments to the original Martz budget were submitted by letter to the Legislative Fiscal Analyst on December 15, 2004. These amendments were not received in time to be included in this analysis. The amendments are summarized on page 114 and amendment items will be addressed individually during the legislative process at the prerogative of the legislature.

Governor-elect Schweitzer's changes to the budget must be submitted to the Legislative Fiscal Analyst and the legislature by January 7th. An analysis, if deemed necessary, of any submitted changes will be provided, in a separate document, to the legislature as soon as possible after the changes are received.

BUDGET COMPARISONS

The total 2007 biennium Martz budget request is \$2.5 billion general fund and \$6.9 billion total funds. The budget (HB 2) reflects a 9.9 percent general fund increase and a 10.6 percent increase in total funds as compared to the 2005 biennium. The overall net increase reflects the improved revenue picture and growing demands for services in almost all sectors of state government. The largest general fund dollar increases appear in Public Health and Human Services, Revenue, Public Education, Corrections, and Higher Education. The largest total fund increases occur in Transportation and Public Health and Human Services. Highlights of the executive budget proposal are presented on page 61.

The legislature and the public use comparisons to prior budgets as a benchmark for assessing budget growth and stability. There are two common methods utilized in the state budget process:

- Base year comparison – this method is used because the state budget is developed from a base year, but is not a good measure of true growth
- Biennial comparison – this is the method prescribed in statute for budget comparisons, and is a better measure because it takes into consideration the cyclical nature of the state budget

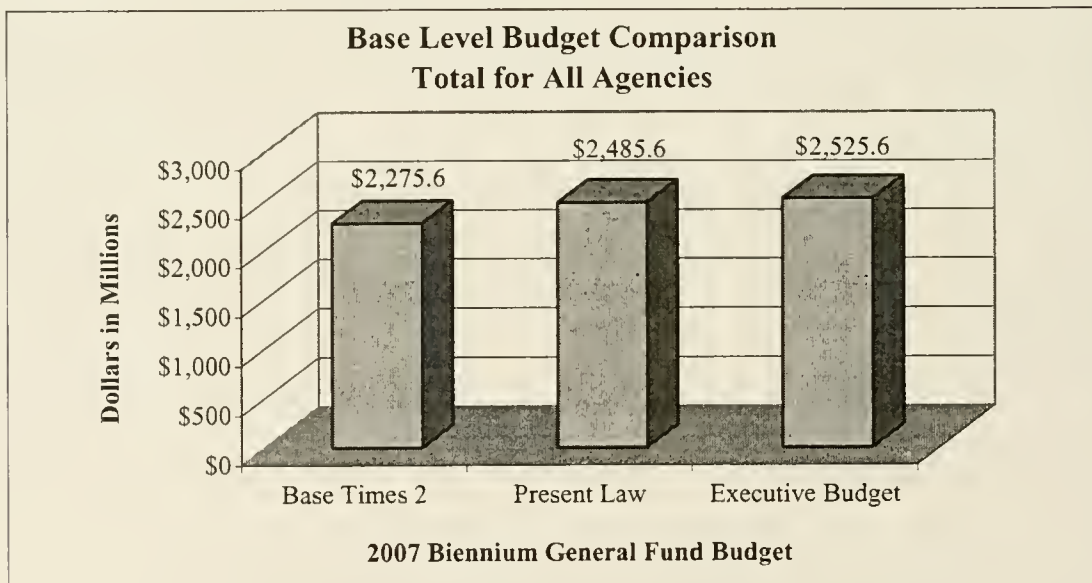
A discussion of each of these budget comparison methodologies follows. Please read the “Comparison Caution” on page 54 for a better understanding of the merits of these differing methodologies.

BASE LEVEL BUDGET COMPARISONS

In this volume and Volumes 3 and 4, the reader will see references to base budget, present law budget, and the executive budget. Important to consider is the relationship between these different looks at the budget. Base budget describes the actual costs for the base year (FY 2004). The present law budget, the amount of funding needed to maintain government services at the level authorized by the previous legislature, is developed for the upcoming biennium, which includes FY 2006 and FY 2007. The executive budget is the budget that is submitted to the legislature for the upcoming biennium, and by statute, must include the components of base and present law, plus the addition of any new proposals that the Governor wishes to pursue. These three levels of the budget are compared in Figure 1.

The base is represented as the base budget times two in order to compare on a biennium basis, and because the FY 2006 and FY 2007 budgets are developed from the base budget data. Figure 1 shows that the present law budget exceeds the base budget by \$210 million, reflecting adjustments to the base for such things as annualization of the 2005 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total executive budget is \$40 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 and 4. The total executive budget is \$250 million greater than the base budget.

Figure 1



BIENNIAL BUDGET COMPARISON

This section summarizes executive recommendations for the 2007 biennium and compares it to expenditures and appropriations for the 2005 biennium.

The executive is recommending a 2007 biennium budget that includes an additional \$273 million general fund, an 11 percent increase over the 2005 biennium. Total requested increases (all funds) amount to \$692 million, a 10 percent increase. The executive proposal for general fund and total spending increases is supported by existing sources of revenue, with the large general fund and federal increases being indicative of substantial general fund and federal revenue increases estimated for the 2007 biennium. Transfers, including the one-time transfers of general fund proposed by the executive, are not included as required by the statutory methodology.

METHODOLOGY

The state budget is highly complex, and the methods used to compute comparisons within the context of that budget can vary considerably. Without consistent comparison methodology, the comparisons can also be subject to manipulation. The Legislative Finance Committee (LFC) developed a budget comparison methodology that measures budget performance using total state expenditures for state general operations funded by taxpayer taxes, licenses, and fees. This method helps ensure proper representation, fairness, balance, and consistency. Adopted by the 1997 legislature, use of the comparison procedures became a statutory requirement at that time. These procedures provide consistency of application and help avoid the potential for manipulation when comparing information.

COMPARISON TO 2005 BIENNIUM

Figures 2 and 3 compare expenditures/appropriations between the 2005 to 2007 biennia for general fund and total funds. As shown in the figures, the largest general fund changes are found in the Department of Public Health and Human Services, Department of Revenue, Office of Public Instruction, Department of Corrections, and the Commissioner of Higher Education. However, the largest increases in percentage terms occur in the departments of Administration, Revenue, Labor and Industry, and Environmental Quality. Only the Department of Agriculture shows a decline.

Figures 2 and 3 are divided into three sections:

1. The top part of the table includes all appropriations recommended for inclusion in HB 2 (the General Appropriations Act), by agency.
2. Because HB 2 does not include all appropriations authorized by the legislature, the second part of the table includes additional executive recommendations. This section is referred to as "Comparable Adjustments" because the items can be compared across biennia. The total shown in the "Total Exec. Budget Fiscal 06-07" (the 2007 biennium) column represents all recommendations made by the executive, with the exception of the non-cash portion of long-range building program, statutory appropriations, and transfers. Long-range building proposals are specifically excluded because spending and timing vary considerably on most building projects. The building expenditures are reflected by the debt service paid over the term of any bonding/leasing agreement. Statutory appropriations represent the executive estimates for non-general fund. General fund statutory appropriations are Legislative Fiscal Division estimates. (Note: The total in

the "Total Adjusted Fiscal 04-05" (the 2005 biennium) column does not represent all contingent appropriations in that biennium, which are included in the third section.)

3. The third section, "Non Comparable Adjustments", includes all 2005 biennium expenditure/appropriations, including budget amendments, supplemental appropriations, and disaster/emergency costs that cannot be estimated for the next biennium. Excluded from the "Comparable Adjustments" total are probable 2007 biennium expenditures that belong in this category. Consequently, the increases of 10.1 percent for general fund and 6.9 percent for total funds do not represent a true picture of potential growth between biennia.

House Bill 2 Comparisons

As shown in Figures 2 and 3, general fund recommendations in HB 2 increase \$227.9 million, or 9.9 percent, and all funds increase \$654.6 million, or 10.6 percent, with \$115 million of increases in state special revenue and \$312 million in federal special revenue. These are primarily due to additional state special expenditures in the Department of Transportation (\$52 million), Department of Public Health and Human Services (\$37 million), and additional federal funds expenditures in DPHHS (\$214 million), Department of Transportation (\$31 million), and K-12 Education (\$19 million).

Appropriation increases are summarized in the "Executive Expenditure Proposals Summary" section of this volume, page 61, and are detailed in the narratives of the specific agencies in Volumes 3 and 4.

Comparable Adjustments

Comparable adjustments include HB 2 plus all miscellaneous appropriation bills, including the employee pay plan bill and other appropriations bills, statutory appropriations, and other appropriation and expenditure adjustments. The executive recommends \$273 million in increased general fund expenditures for the 2007 biennium as compared to the 2005 biennium, an increase of 10.6 percent. The increase in total all funds spending over comparable 2005 biennium spending is \$692 million, or 10.1 percent.

Non-Comparable Adjustments

Non comparable adjustments, the third section, shows increases of 10.1 percent general fund and 6.9 percent total funds between biennia. As stated earlier, this comparison tends to be distorted by the lack of comparable information for the 2005 biennium. This section and these comparisons are shown for informational purposes only and to complete the listing of 2003 biennium expenditures.

COMPARISON CAUTION

Biennial Comparisons vs. Budget Base Comparisons

This volume compares the 2007 biennium Executive Budget to actual expenditures and expenditures/appropriations for the 2005 biennium. The methodology used is that prescribed by the budget comparison statute, and upholds the concept of a comparison of the total state budget from biennium to biennium. This is a particularly useful practice due to the cyclical nature of annual budgets. However, because the Executive Budget is prepared using a different statutorily defined process, there is a difference between the total changes indicated in this volume and those indicated in the individual agency and program budgets discussed in the Agency Budgets and Analysis section in Volumes 3 and 4.

Because present law adjustments are added to the base year (fiscal 2004) to determine a present law budget for the 2007 biennium and budget growth as prescribed by total adjustments, the intermediate year (fiscal 2005) is ignored. This method facilitates budget development from a vantage point of recent, actual experience, but overstates true budget growth because all increases are measured from the base year.

Conversely, using the base year (2004) plus fiscal 2005 appropriations for budget comparisons more accurately reflects true budget growth. This is because the increases/decreases are measured from a biennial perspective that takes into account the annual increase from the base year to the fiscal 2005 appropriated amount.

While consideration of increases over the base year is necessary to making budgetary decisions, the adjustments should not be used as measures of growth or for comparative purposes. When making comparisons, the total budget for the 2007 biennium should be examined in comparison with the total 2005 biennium, as described above.

Figure 2

General Fund Comparison
2005 Biennium Versus Executive Budget 2007 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 2007 Biennium - 2005 Biennium	% Change 2007 Biennium 2005 Biennium
1104	Legislative Branch	\$16,106,258	\$16,756,076	\$649,818	4.03%
2110	Judicial Branch	58,541,313	70,694,143	12,152,830	20.76%
3101	Governor's Office	8,818,012	9,603,495	785,483	8.91%
3202	Commissioner Of Political Practices	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	0	0	0	NA
3501	Office Of Public Instruction	1,028,977,504	1,057,188,753	28,211,249	2.74%
4107	Crime Control Division	3,274,487	3,437,597	163,110	4.98%
4110	Department Of Justice	37,468,284	40,758,771	3,290,487	8.78%
5101	Board Of Public Education	305,290	332,640	27,350	8.96%
5102	Commissioner Of Higher Education	277,986,004	300,404,277	22,418,273	8.06%
5113	School For The Deaf & Blind	6,916,681	7,936,967	1,020,286	14.75%
5114	Montana Arts Council	576,604	647,261	70,657	12.25%
5115	Montana State Library	3,214,435	3,407,572	193,137	6.01%
5117	Montana Historical Society	3,481,698	3,812,033	330,335	9.49%
5301	Department Of Environmental Quality	6,217,300	8,226,437	2,009,137	32.32%
5603	Department Of Livestock	1,054,263	1,102,712	48,449	4.60%
5706	Dept Of Natural Resources & Conservation	34,320,252	42,916,695	8,596,443	25.05%
5801	Department Of Revenue	56,348,979	90,229,399	33,880,420	60.13%
6101	Department Of Administration	6,914,319	11,907,993	4,993,674	72.22%
6102	Appellate Defender	373,462	397,616	24,154	6.47%
6201	Department Of Agriculture	1,226,366	1,189,056	(37,310)	-3.04%
6401	Department Of Corrections	210,647,987	234,784,069	24,136,082	11.46%
6501	Department Of Commerce	3,149,336	3,250,436	101,100	3.21%
6602	Department Of Labor & Industry	2,353,932	3,674,419	1,320,487	56.10%
6701	Department Of Military Affairs	8,306,330	8,742,940	436,610	5.26%
6901	Dept Of Public Health & Human Services	<u>520,511,199</u>	<u>603,549,186</u>	<u>83,037,987</u>	<u>15.95%</u>
Total		\$2,297,723,185	\$2,525,598,241	\$227,875,056	9.92%
Comparable Adjustments					
	Employee Pay Proposal	In Above	31,544,045	31,544,045	
	Statutory Appropriations	255,227,183	268,691,065	13,463,882	5.28%
	Legislative Session Costs *	7,758,613	10,150,000	2,391,387	30.82%
	Miscellaneous Appropriations	31,716,939	12,225,000	(19,491,939)	-61.46%
	One-Time Only Costs	5,230,720		(5,230,720)	-100.00%
	Anticipated Reversions	(28,662,000)	(5,855,000)	22,807,000	-79.57%
	Total With Comparable Adjustments	\$2,568,994,640	\$2,842,353,351	\$273,358,711	10.64%
Non Comparable Adjustments					
	Budget Amendments	0		0	
	Supplementals	12,650,382		(12,650,382)	-100.00%
	Disaster/Emergency Costs (SA)	33,760	0	(33,760)	-100.00%
	Total With All Adjustments	\$2,581,678,782	\$2,842,353,351	\$260,674,569	10.10%
* Reversions of \$3,154,812 and \$3,150,000 are expected in the 2005 and 2007 biennia, respectively.					

Figure 3

All Funds Comparison
2005 Biennium Versus Executive Budget 2007 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 2007 Biennium - 2005 Biennium	% Change 2007 Biennium 2005 Biennium
1104	Legislative Branch	\$20,164,335	\$20,969,368	\$805,033	3.99%
1112	Consumer Council	2,645,816	2,768,221	122,405	4.63%
2110	Judicial Branch	64,828,673	74,912,145	10,083,472	15.55%
3101	Governor's Office	21,383,896	20,009,849	(1,374,047)	-6.43%
3201	Secretary Of State's Office	0	11,026,465	11,026,465	NA
3202	Commissioner Of Political Practices	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	9,429,943	10,212,169	782,226	8.30%
3501	Office Of Public Instruction	1,309,165,538	1,356,419,284	47,253,746	3.61%
4107	Crime Control Division	27,583,033	30,817,274	3,234,241	11.73%
4110	Department Of Justice	107,514,911	111,393,714	3,878,803	3.61%
4201	Public Service Regulation	5,943,474	5,715,138	(228,336)	-3.84%
5101	Board Of Public Education	649,375	717,625	68,250	10.51%
5102	Commissioner Of Higher Education	391,504,387	420,802,046	29,297,659	7.48%
5113	School For The Deaf & Blind	7,793,250	8,708,201	914,951	11.74%
5114	Montana Arts Council	2,093,201	2,186,409	93,208	4.45%
5115	Montana State Library	7,267,048	7,466,455	199,407	2.74%
5117	Montana Historical Society	7,731,532	8,414,189	682,657	8.83%
5201	Department Of Fish, Wildlife & Parks	107,793,794	116,409,329	8,615,535	7.99%
5301	Department Of Environmental Quality	114,755,361	139,836,831	25,081,470	21.86%
5401	Department Of Transportation	1,133,065,121	1,215,955,351	82,890,230	7.32%
5603	Department Of Livestock	16,748,481	16,201,608	(546,873)	-3.27%
5706	Dept Of Natural Resources & Conservation	72,081,283	86,640,136	14,558,853	20.20%
5801	Department Of Revenue	65,985,149	96,313,176	30,328,027	45.96%
6101	Department Of Administration	34,575,942	43,113,949	8,538,007	24.69%
6102	Appellate Defender	373,462	397,616	24,154	6.47%
6106	Mt Consensus Council	513,141	396,548	(116,593)	-22.72%
6201	Department Of Agriculture	22,354,505	27,341,542	4,987,037	22.31%
6401	Department Of Corrections	217,073,483	242,235,111	25,161,628	11.59%
6501	Department Of Commerce	38,107,439	44,953,910	6,846,471	17.97%
6602	Department Of Labor & Industry	127,113,412	132,484,291	5,370,879	4.23%
6701	Department Of Military Affairs	33,642,734	35,476,579	1,833,845	5.45%
6901	Dept Of Public Health & Human Services	<u>2,234,600,021</u>	<u>2,569,004,373</u>	<u>334,204,352</u>	<u>14.95%</u>
Total		\$6,205,314,630	\$6,859,946,600	\$654,631,970	10.55%
Comparable Adjustments					
Employee Pay Proposal		In Above	63,084,241	63,084,241	
Statutory Appropriations		634,370,097	608,233,561	(26,136,536)	-4.12%
Legislative Session Costs		7,758,613	10,150,000	2,391,387	30.82%
Miscellaneous Appropriations *		31,716,939	12,225,000	(19,491,939)	-61.46%
One-Time Only Costs (general fund)		5,230,720	0	(5,230,720)	-100.00%
Anticipated Reversions (general fund)		(28,662,000)	(5,855,000)	22,807,000	-79.57%
Total With Comparable Adjustments		\$6,855,728,999	\$7,547,784,402	\$692,055,403	10.09%
Non Comparable Adjustments					
Budget Amendments		193,584,323		(193,584,323)	-100.00%
Supplementals		12,650,382		(12,650,382)	-100.00%
Disaster/Emergency Costs (SA)		33,760	0	(33,760)	-100.00%
Total With All Adjustments		\$7,061,997,464	\$7,547,784,402	\$485,786,938	6.88%

* Only the general fund portion is shown. All funds cannot be determined based on existing accounting records.



EXECUTIVE REVENUE PROPOSALS - SUMMARY

INTRODUCTION

The Executive Budget is based on estimated general fund revenues below those adopted by the Revenue and Transportation Committee on November 16, 2004. For a complete discussion of revenue estimates, see "General Fund Revenue Estimates" on page 41 of this report and Volume 2, Legislative Budget Analysis, Revenue Estimates.

This section presents a description of the revenue and tax policy proposals contained in the executive budget. Unlike previous budget proposals, the budget as submitted by Governor Martz does not include any tax policy proposals. There are two revenue initiatives that impact the revenue available to the general fund. These initiatives are discussed below.

REVENUE PROPOSALS

DEPARTMENT OF REVENUE COMPUTER SYSTEM LOAN

Senate Bill 271, adopted by the 58th Legislature, authorized the Department of Revenue (DOR) to secure up to a \$17.1 million loan from the Board of Investments. The loan was to be used to implement a new computer system to replace the existing Process Oriented Integrated Tax System (POINTS). Under the provisions of SB271, the loan was to be repaid through an assessment fee of up to 0.45 percent of selected general fund revenue sources. In FY 2004, the department assessed a fee against only the individual income tax for purposes of repayment.

The DOR is currently in the process of implementing the new system called the Integrated Revenue Information System (IRIS). In an effort to utilize available one-time general fund revenue, the executive budget proposes to use these one-time monies to pay off the loan to the Board of Investments. The loan balance is expected to be approximately \$16.0 million. As a result of the total loan repayment, the department assessment fee would be eliminated, which would increase individual income tax revenues to the general fund by \$6.0 million during the 2007 biennium.

DEPARTMENT OF JUSTICE PATHOLOGIST

The executive budget for the Department of Justices is requesting a pathologist associate medical examiner to address the increased number of autopsies conducted at the forensic lab. A forensic pathologist is responsible for determining the cause and manner of sudden unexpected deaths, or deaths unattended by a physician. The pathologist performs forensic autopsies, collects evidence to be analyzed by other scientists in the laboratory, serves as an advisor to the coroners throughout Montana, and reviews all coroners' reports on deaths occurring in the state. The forensic pathologist also assists investigators and scientists with crime scene reconstruction. Forensic pathology requires

specialized training and cannot be performed by hospital pathologists due to the nature of criminal cases.

The costs of these services would be billed to and paid by the counties in which the services were provided. The revenue collected would be deposited into the general fund to offset the cost of the additional pathologist position. The additional revenue is expected to be \$317,000 for the 2007 biennium.



EXECUTIVE EXPENDITURE PROPOSALS - SUMMARY

INTRODUCTION

This section discusses the major expenditures in the 2007 biennium proposed by Governor Martz. The purpose of this document is to provide the reader with a summary view of major trends and policies proposed. It is divided into two parts:

- A brief overview of general fund in total, including all appropriations made by both temporary and statutory appropriations, and all executive proposals that are contained in legislation separate from the general appropriations act (HB 2)
- A more detailed discussion of executive proposals in HB 2, which appropriates over 86.6 percent of all general fund expended by state government. This discussion does not include other major initiatives such as the state employee pay plan, statutory appropriations, and other non-HB 2 measures to balance the general fund budget. A detailed discussion of each agency's proposed budget is included in Volumes 3 and 4 of the Legislative Budget Analysis.

ALL GENERAL FUND – HIGHLIGHTS AND SUMMARY

COMPARISON TO THE 2004 BASE

FY 2004 is used as the starting point, or base, for all budget development, rather than the 2005 biennium. Therefore, spending proposals are presented as changes to that base.

Figure 1 shows the Governor's priorities from the doubled 2004 base. As shown, provision of services to recipients of various human services programs is over 25 percent of the total, followed by provision of a state employee pay plan and maintenance on state facilities. If funds to address rising populations in the state institutions are added, the total increases to over half of the proposed expenditure increase.

Figure 1

Major Factors - General Fund Increase
From the Doubled FY 2004 Base
2007 Executive Budget
(Millions)

Element	Funds	--- General Fund ---	
		Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,564.1	---	---
<u>Major Adjustments - \$354 million</u>			
Medicaid Matching Rate*	\$55.0	15.5%	15.5%
Human Services Caseloads and Service Changes	38.3	10.8%	26.4%
State Employee Pay Plan	31.6	8.9%	35.3%
Maintenance of State Buildings	30.0	8.5%	43.7%
Corrections Populations and Overtime	24.0	6.8%	50.5%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	6.5%	57.0%
MUS Enrollment/K-12 Enrollment/Inflation	19.4	5.5%	62.5%
Statutory Appropriations	15.5	4.4%	66.9%
Statewide Present Law Adjustments	15.4	4.4%	71.2%
Computer Systems Update/Completion/Replacement	13.5	3.8%	75.1%
MUS Shared Leadership/Equipment	9.9	2.8%	77.9%
Pension Funds Actuarial Soundness	7.2	2.0%	79.9%
DPHHS Institutional Costs (overtime, utilities, etc.)	6.6	1.9%	81.8%
License Plate Manufacture/Replacement**	4.5	1.3%	83.0%
Emergency Telecommunications	4.1	1.2%	84.2%
Protested Property Tax Reserve	4.0	1.1%	85.3%
Replace Cultural Trust Balance	3.9	1.1%	86.4%
All Other Agencies/Purposes (including feed bill and reversions)	48.1	13.6%	100.0%
Total 2007 Biennium	\$2,918.1	---	---

*Includes \$1.1 million for non-Medicaid expenditures that use the Medicaid matching rate.

**Includes expenditures in corrections and the Department of Justice

HB 2 PROPOSALS – HIGHLIGHTS AND SUMMARY

INTRODUCTION

The Governor proposes to spend \$2.5 billion general fund and \$6.9 billion total funds in HB 2 in the 2007 biennium. Figure 2 shows proposed general fund expenditures in the 2007 biennium by functional area of government.

K-12 education, human services, higher education, and corrections would consume 86.9 percent of the general fund budget in the 2007 biennium, compared to 88.7 percent in the 2005 biennium.

Figure 2

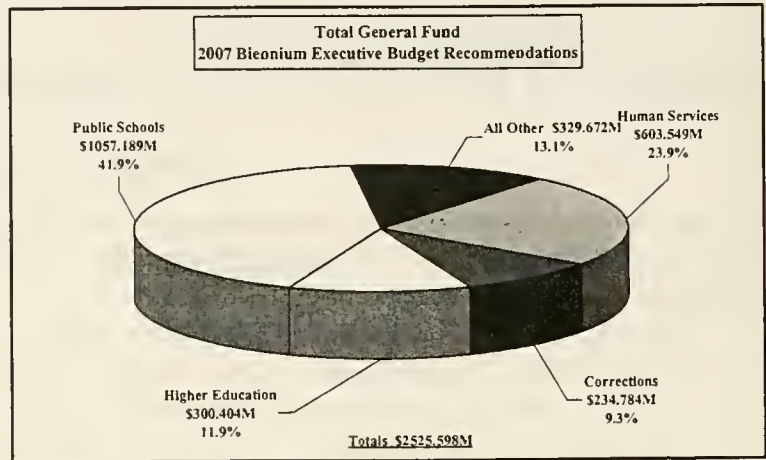
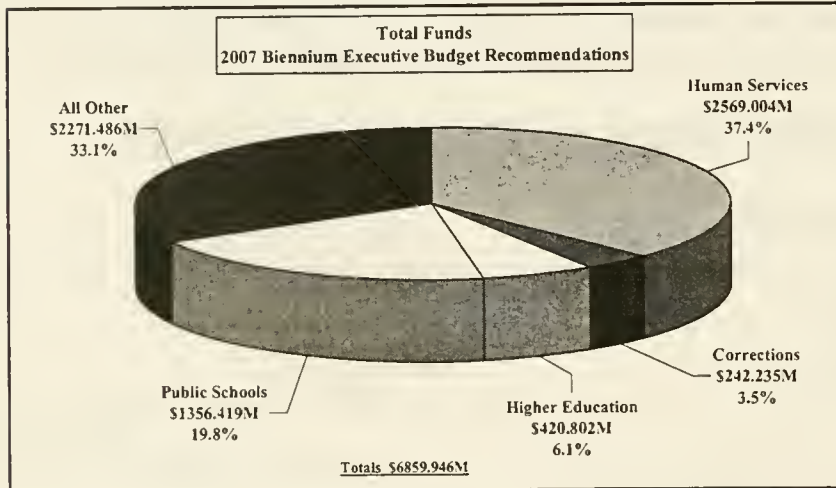


Figure 3



Because K-12 education, the HB 2 portion of higher education, and corrections are primarily funded with general fund, the picture changes significantly when looking at total funds. Human services, transportation, and environmental functions (including fish and wildlife management) all have an either significant state special revenue and/or federal funding presence. Figure 3 shows the total funds proposed by the Governor in the 2007 biennium. Human services and “all other government” (which includes

transportation and environmental functions) would be 70.5 percent of the total, compared to 69.1 percent in the 2005 biennium.

INCREASES OVER THE 2005 BIENNIUM

The 2007 biennium totals in HB 2 are an increase in general fund of \$227.9 million and in total funds of \$654.6 million over the 2005 biennium.

General Fund Increases

Figure 4

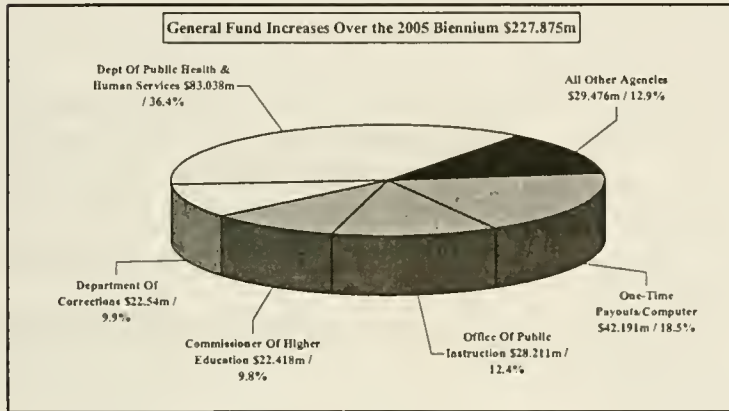


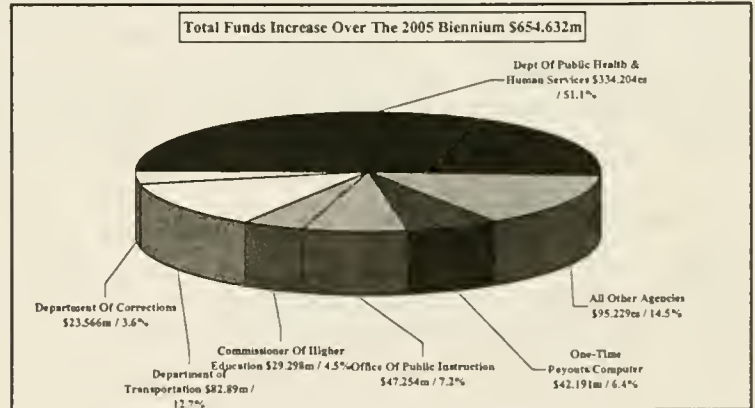
Figure 4 shows the Governor's allocation of the increases, by functional area of government. In that figure, the largest areas of increase in general fund are human services and all other government. The budget includes over \$42 million in one-time expenditures for payoff of debt and settlement agreements, and various one-time computer and other equipment purchases.

Figure 4 shows the allocation of the increase with these one-time expenditures separated.¹

Total Funds Increases

Figure 5 shows the allocation of increases in total funds, with the same one-time expenditures broken out. Please note that this figure also breaks out the Department of Transportation for illustrative purposes. That department is funded entirely with state special or federal revenue.

Figure 5



MARTZ ADMINISTRATION PRIORITIES

General Priorities

Several priorities are evidenced by the spending proposals of Governor Martz. The Governor:

- Funds all caseload increases in human services (even though the general fund portion of the cost of Medicaid goes up because of a reduction in the federal participation rate), and proposes a number of other service enhancements

¹ The Governor added over \$94 million in one-time expenditures (total excludes \$2 million in offsets for Crow Tribe settlement payments). However, \$8.9 million is included in the higher education total for one-time equipment purchases and shared leadership, \$4.4 million is included in the Department of Corrections to manufacture the new issue license plates, over \$1.0 million in several agencies for various purposes; and almost \$38 million is either appropriated in other bills or done via transfer.

- Funds all anticipated enrollment increases in K-12 and higher education, and funds a greater percentage of operating increases in higher education with general fund to reduce potential tuition increases
- Includes a statutory inflationary increase for K-12 Base Aid costs and increases in a number of other programs, including special education, school facilities, gifted and talented, and vocational education
- Adds private contract beds (private prisons and pre-release centers) to address correctional population growth, along with additional probation and parole officers
- Proposes a major economic development partnership with Montana University System, as well as major equipment purchases for two year education
- Funds all anticipated federal funds and state match for highways construction and maintenance, as well as continuance of Highway 93 construction
- Adds most anticipated federal funding increases, but would leave the bulk of any homeland security funding to be added during the interim
- Proposes to complete the total maximum daily load (TMDL) project and fully funds all positions in the Department of Environmental Quality
- Funds the personal services costs of all state employees, but then reduces the number funded with general fund by 60 FTE

The Governor does not include either of the following:

- Funding for any initiatives to address the recent court rulings on the school funding lawsuit
- Any homeland security funds that would go to the Department of Military Affairs for allocation to other entities

Governor's Priorities - Comparison to the Base

FY 2004 is used as the starting point, or base, for all budget development, rather than the 2005 biennium. Therefore, spending proposals are presented as changes to that base. The following discusses the Governor's priorities from the doubled 2004 base. The general fund increase from the base year is \$250 million compared to the \$228 million increase using a biennial comparison.

Increases by Activity

Figure 6 lists the major increases in the proposed budget by specific type of activity. The figure shows that over 37 percent of the total general fund increase (first two items) would be used to maintain and expand services to various recipients of human services. If the costs to operate the human services institutions are also added (6.6 percent), the total goes to 40 percent. Adding costs to address the growing correctional populations would bring the total to almost half of the general fund increase.

Figure 6 Major Factors - General Fund HB 2 Increase From the Doubled FY 2004 Base 2007 Executive Budget			
Element	Funds	--- General Fund ---	
		Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,275.6	---	---
<u>Major Adjustments - \$250.0 million</u>			
Medicaid Matching Rate*	\$55.0	22.0%	22.0%
Human Services Caseloads and Service Changes	38.3	15.3%	37.3%
Corrections Populations and Overtime	24.0	9.6%	46.9%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	9.2%	56.1%
MUS Enrollment/K-12 Enrollment/Inflation	19.4	7.8%	63.9%
Statewide Present Law Adjustments	15.4	6.2%	70.0%
Computer Systems Update/Completion/Replacement	13.5	5.4%	75.5%
MUS Shared Leadership/Equipment	9.9	4.0%	79.4%
DPHHS Institutional Costs (overtime, utilities, etc.)	6.6	2.6%	82.1%
License Plate Manufacture/Replacement**	4.5	1.8%	83.9%
Emergency Telecommunications	4.1	1.6%	85.5%
All Other Agencies	36.2	14.5%	100.0%
Total 2007 Biennium	\$2,525.6	---	---

Increases by Functional Area of Government

The proposed general fund increases can also be examined by general functional area, which shows that human services in total would receive over 40 percent of the total general fund increase, and the addition of K-12 education, corrections, and higher education would total over 72 percent of total general fund increases. When one-time expenditures for debt and/or settlement costs, computer enhancement, and telecommunications infrastructure are added, they comprise almost 90 percent of the Martz administration proposed general fund increases, as shown in Figure 7.

As a result of these priorities, the amount of general fund going to human services would increase from 22.6 percent of the total in the 2005 biennium to 23.9 percent in the 2007 biennium.

Governor's Priorities – Summary

The following provides a reference to the major changes proposed by the Governor, and their impact on source and allocation of funding.

Figure 7 Major Factors - General Fund HB 2 Increase From the Doubled FY 2004 Base 2007 Executive Budget			
Element	--- General Fund ---		
	Funds	Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,275.6	---	---
Major Adjustments - \$250.0 million			
Human Services	\$106.7	42.7%	42.7%
K-12 Education	29.0	11.6%	54.3%
Corrections	26.7	10.7%	65.0%
Higher Education	18.8	7.5%	72.5%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	9.2%	81.7%
Computer Systems Update/Completion/Replacement	13.5	5.4%	87.1%
Emergency Telecommunications	4.1	1.6%	88.7%
All Other Agencies	28.1	11.2%	100.0%
Total	\$2,525.6	---	---

FTE

FTE would increase by over 106 in FY 2006, with a drop of about 15 FTE in FY 2007, for a total increase over the biennium of 91.16. Major increases are in the Departments of Transportation; Fish, Wildlife, and Parks, and Environmental Quality. Increases are partially offset by a reduction in 60 FTE funded with general fund to make permanent personal services reductions enacted by the 2003 Legislature

General Fund/Total Funds**General Fund
Total Funds**

General fund increases by \$227.9 million, or 9.9 percent, to \$2.5 billion
Total funds increase by \$654.6 million, or 10.6 percent, to \$6.9 billion

Major Present Law Adjustments**Human Services**

- Maintenance of Medicaid recipient eligibility through additional total funding, and increased general fund required by reduction in the federal participation rate

K-12 Education

- Inflationary increases and adjustments for enrollment changes
- Maintenance of FY 2005 expenditures for special education
- Utilization of all anticipated federal funding increases

Higher Ed

- Adjustments for anticipated enrollment increases
- Increase in percent of general operating expense increases funded with general fund to reduce tuition increases

Corrections

- Increases in private contract beds, private pre-release beds, and probation and parole officers to address rising populations
- New issue license plate manufacturing costs

All Other Gov't

- Operate IRIS (Integrated Revenue Information System)
- Complete total maximum daily load (TMDL) in environmental programs, and match anticipated federal funds for highways construction, and other purposes

All Agencies

- Statewide present law adjustment for personal services, fixed costs, and inflation

Major New Initiatives**Human Services**

- Medicaid redesign initiatives to utilize existing state resources to expand coverage
- Continued utilization of tobacco control and prevention funds for other programs
- Increased enrollment in CHIP
- Continuation of hospital provider tax, bed tax, and intergovernmental transfers to match additional federal funds

K-12 Education

- Increased special education, gifted and talented, school facility payments, and vocational education payments to schools
- Planning and coordination of Indian Education for All

Higher Ed

- Economic development partnership funds and equipment purchases

Corrections

- Replacement of the offender tracking system

All Other Gov't

- Payoff of certain debts and settlements*
- Completion of computer systems
- Emergency telecommunications
- Judiciary payment of "unfit to proceed" costs

Fund Source

The budget once again continues a trend in recent biennia of a growing federal share of the total state budget (page 71). However, the increase in federal fund share is significantly smaller than in previous biennia due to the almost 10 percent increase in general fund, and in part due to a reduction in the percentage of Medicaid benefits costs paid by the federal government.

Functional Share of the Budget

K-12 education's share of the general fund budget continues to fall due primarily to continued falling enrollments, and large increases in human services and one-time expenditures. Human services would increase to 23.9 percent of the total.

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes just over \$40 million in general fund new initiatives in HB 2, and an additional \$72 million outside of HB 2. The Governor's new initiatives are presented in more detail on page 96.

Figure 9
Major New Initiatives - Executive Budget
2007 Biennium
(Millions)

Agency/Initiative	Amount
<u>Revenue Proposals</u>	
Department of Revenue Loan Payback*	(6.0)
Department of Justice Pathologist	(0.3)
Total Revenue Proposals (revenue increase)	(6.3)
<u>Expenditure Proposals</u>	
Increased repair/maintenance (long-range building)	\$30.0
State employee pay plan	31.6
Protested property tax reserve	4.0
Replace cultural trust fund balance	3.9
Pay federal government for share of workers' compensation transfer to general fund	0.2
Pension funds actuarial soundness	7.2
Other Language Appropriations	1.4
Total Non-HB 2 Expenditure New Proposals	\$78.3
<u>HB 2</u>	
Various - Enhance/Complete Computer Systems**	\$9.9
OPI - Various Education Programs	5.5
University System - 2 Year Education Units Equipment	5.0
University System - Shared Leadership	4.9
Administration - Emergency Telecommunications	4.1
DPHHS - Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	2.2
Judiciary - "Unfit to Proceed" Costs	2.0
DPHHS - Nursing Home Bed Tax	1.9
DPHHS - CHIP Enrollment Increase	1.7
Labor and Industry - Employment Security Account Funding Switches***	1.2
DPHHS - Child Support Maintenance	0.8
DPHHS - Continuance of Diversion of Tobacco Tax	0.7
Administration - Public Safety Communications	0.6
OPI - Indian Education for All	0.5
Other Agencies, Net of Miscellaneous Reductions****	-1.0
Total HB 2 New Proposals	\$40.0
Total Expenditure New Proposals	\$118.3
Total New Proposals	\$112.0

*Savings as a result of \$16 million IRIS debt payoff

**Includes only those enhancement requested in new proposals. As such, it excludes completion of POINTS, and the gambling control enhancement.

***Reversal of fund switch enacted by the 2003 Legislature

****Various costs savings in DPHHS total \$3.1 million. The Department of Justice statewide FTE reduction (\$0.46 million) is included in new proposals.

EXECUTIVE PROPOSALS BY PROGRAM AREA

Figure 10 summarizes expenditures of state government as proposed by the Governor and compares these totals to the 2005 biennium, by function of government. For a graphic display (pie charts) of the data in Figure 10, see Figure 2 (General Fund Budget), Figure 3 (Total Funds Budget), Figure 4 (General Fund Increases), and Figure 5 (Total Fund Increases).

Each of the program areas, along with the Department of Transportation, is discussed in the narrative that follows. Further discussion is included in the individual agency narratives in Volumes 3 and 4.

K-12 Education

The budget for OPI in the 2007 biennium exceeds the 2005 biennium by \$47.1 million. \$46.9 million is in the distribution to schools program. Of this amount, \$19.8 million is due to increases in federal funds, and \$27.1 million is increases in the general fund.

In the 2005 biennium, 297,120 students will be served, and it is expected that in the 2007 biennium 289,225 students will be served, a reduction of 7,895 students. At constant entitlements, the state would have saved \$25.0 million in Base Aid between biennia as a result of declines in student numbers. However as a result of an increase in Base Aid entitlements in FY05 (2.07 percent) and budgeted inflationary increases in FY2006 (2.1 percent) and FY2007 (2.19 percent), the general fund biennial difference due to entitlement increases is \$48.3 million, for a net biennial increase in general fund Base Aid of \$23.3 million. In addition, state special education grants in the general fund increase by \$3.8 million between the biennia.

For a further discussion, see the Office of Public Instruction narrative beginning on page E-1 of Volume 4.

Higher Education

The 2007 biennium executive budget for the Montana University System proposes increases (through both present law adjustments and new proposals) that total \$22.4 million general fund (\$29.3 million total funds) above the 2005 biennium budget.

These increases are driven primarily by the following two changes in the university system budget:

- Shared Leadership Project initiatives, which seek to position the university system as an engine of economic development in Montana, total \$9.9 million general fund for new proposals

Figure 10
Proposed Executive Budget by Program Area - HB 2
2005 to 2007 Biennia

--- General Fund ---				
Component	Executive Budget	Increase Over 2005	Percent Increase	Percent of Increase
K-12 Education	\$1,057,188,753	\$28,211,249	2.7%	12.4%
Higher Education	300,404,277	22,418,273	8.1%	9.8%
Corrections	234,784,069	24,136,082	11.5%	10.6%
Human Services	603,549,186	83,037,987	16.0%	36.4%
All Other Government Agencies	329,671,956	70,071,465	27.0%	30.7%
Total	\$2,525,598,241	\$227,875,056	9.9%	
--- Total Funds ---				
Component	Executive Budget	Increase Over 2005	Percent Increase	Percent of Increase
K-12 Education	\$1,356,419,284	\$47,253,746	3.6%	7.2%
Higher Education	420,802,046	29,297,659	7.5%	4.5%
Corrections	242,235,111	25,161,628	11.6%	3.8%
Human Services	2,569,004,373	334,204,352	15.0%	51.1%
All Other Government Agencies	2,271,485,786	218,714,585	10.7%	33.4%
Total	\$6,859,946,600	\$654,631,970	10.5%	

- Changes in the funding formula that determines the state share of operational costs in the university units result in state funding at approximately an 80 percent level as opposed to the historical formula of 43 percent - The total state share of increased university operating costs in the 2007 biennium is \$11.5 million general fund--\$5.3 million of that increase can be attributed to the executive 80 percent funding level

Enrollment projections in the executive budget, on the other hand, include modest increases at the university educational units, averaging 0.59 percent per year in the 2007 biennium.

In the area of tuition, the executive budget proposes that university educational unit tuition should only need to increase at a 2 percent per year rate during the 2007 biennium, including the executive proposal for HB 13 (state employee pay plan). However, the Office of the Commissioner of Higher Education projects that the executive budget, together with the HB 13 (pay plan) proposal, would lead to tuition increases of 4.3 percent in FY 2006 and 4.4 percent in FY 2007.

For a further discussion, see the narrative for the Office of the Commissioner of Higher Education beginning on page E-75 in Volume 4.

Corrections

The Governor proposes increases in the 2007 biennium of \$24.1 million general fund (\$25.2 million total funds), or 11.5 percent over the 2005 biennium. The Governor has addressed the projected increase in adult male offenders by proposing the expansion of private, contract prison and pre-release beds as well as an increase in the number of probation and parole officers.

The Governor proposes the following increases:

- \$13.2 million for additional offender beds in non-state owned facilities (contract facilities)
- \$4.4 million to produce new license plates to support the January 1, 2006 mandated replacement
- \$2.7 million for additional pre-release beds
- \$1.6 million for a new automated offender tracking system
- \$1.4 million for additional staff in probation and parole

The average daily population, which grew by 4.46 percent during FY 2004, is expected to grow by 4.40 percent during FY 2005 and by 4.44 percent and 4.50 percent during FY 2006 and FY 2007, respectively. This increase is 1,443 additional offenders between FY 2004 and FY 2007. The average daily population in secure facilities is expected to grow from 2,646 in FY 2004 to 3,194 in FY 2007, which is an increase of 548 offenders, or 20.7 percent.

For a further discussion, see the narrative for the Department of Corrections beginning on page D-64 of Volume 4.

Human Services

The DPHHS 2007 biennium budget request is \$334 million total funds higher than the 2005 biennium budget of \$2.2 billion. General fund increases from \$520 million to \$603 million, or 16 percent. The increase is dominated by maintenance of services to Medicaid recipients and other service recipients due to caseload growth. The Governor also proposes a number of initiatives, including Medicaid

redesign, which would utilize existing state funds to expand services with federal funds. Budget increases are due to:

- Medicaid eligibility, service utilization changes, and rate changes - \$190 million total funds (\$32 million general fund)
- Food stamp increases - \$45 million federal funds
- Health Insurance Flexibility and Accountability (HIFA) Waiver, which is part of Medicaid redesign - \$20 million federal funds
- Increases in cash assistance, work support grants, and other initiatives - \$16 million in federal TANF (Temporary Assistance for Needy Families) block grant funds
- Child care benefits - \$14 million in TANF block grant funds
- Federal categorical grants for public health, emergency preparedness, and federal commodity distribution - \$13 million federal funds
- Continued diversion of a portion of the tobacco settlement proceeds from tobacco control and prevention to other uses - \$11.9 million state special revenue
- Foster care and subsidized adoption caseload growth - \$6.9 million total funds (\$3.5 million general fund)
- State institution costs for overtime, and inflation in medical, food, and utility costs - \$5 million general fund

Medicaid services are a significant component of the DPHHS budget, totaling \$1.3 billion in expenditures for the 2007 biennium, or almost 60 percent of the total DPHHS request. Medicaid services are funded by state funds (about 30 percent) and federal funds (about 70 percent). The 2007 biennium DPHHS budget request grows \$55 million in general fund and declines by a like amount of federal funds due to federal Medicaid match rate changes.

For a further discussion, see the narrative for the Department of Public Health and Human Services beginning on page B-1 of Volume 3.

Transportation

The Department of Transportation 2007 biennium budget request has an additional \$82.9 million over the 2005 biennium. The proposals that contribute significantly to this increase are:

- Increases for payments to highway construction contractors and for other related construction activities for the federal-aid construction program
- Re-appropriation of 2005 biennium funding for construction of the project on US Highway 93 between Evaro Hill and Polson, due to project delays in FY 2004
- Re-appropriation of 2005 biennium funding for a runway rehabilitation project at the Lincoln airport, due to project delays in FY 2004
- Transfer of the Motor Carrier Assistance Program to the department from the Department of Justice

For a further discussion, see the narrative for the Department of Transportation beginning on page A-97 of Volume 3.

All Other Agencies

Major changes in other agencies comprise a large share of the increase in both general fund and total funds. Major general fund changes include:

- Payoff of all debt for the Department of Revenue's revenue system (IRIS) - \$16.0 million

- Payoff of the Crow Tribe settlement - \$7.0 million
- Increased costs of district courts, including additional costs to pay “unfit to proceed” costs at Montana State Hospital - \$12.2 million
- Initial costs of an emergency telecommunications network - \$4.1 million
- Total funds increase for the reasons above, and the following:
 - Addition of federal funds for the Help America Vote Act - \$11 million
 - Additional federal grants and expenditures from the general license account for a variety of purposes in the Department of Fish, Wildlife, and Parks - \$8.6 million
 - Major Facility Siting Act (MFSA), CERLA, MEPA, orphan share, and mine waste bonding and/or project authority in the Department of Environmental Quality, along with miscellaneous other expenses and completion of the total maximum daily load project - \$25.1 million

EXECUTIVE PROPOSALS BY FUND SOURCE

Figure 11 shows the allocation by funding source of state government in HB 2 in the 2007 biennium. This pie chart graphically displays the heavy reliance of this state on the use of federal funds for state services, as federal funds have grown to nearly half of the total budget.

As shown in Figure 12, general fund would increase by \$227.9 million, or 9.9 percent. State special would increase by \$115.9 million, or 11.6 percent. Federal funds would increase by \$311.8 million, or 10.8 percent. Reasons for the increases are discussed below, by fund type.

Figure 11

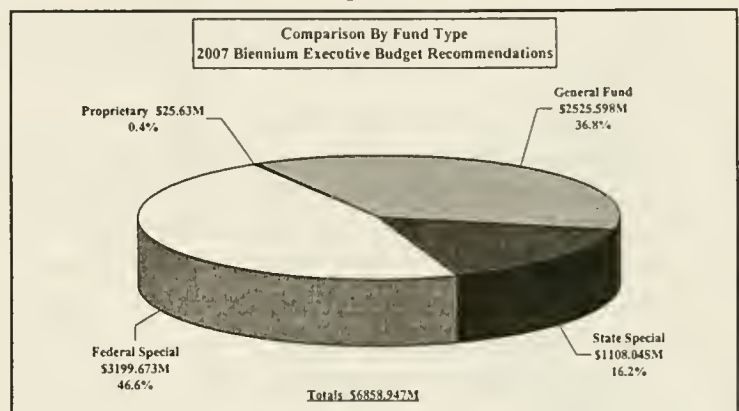
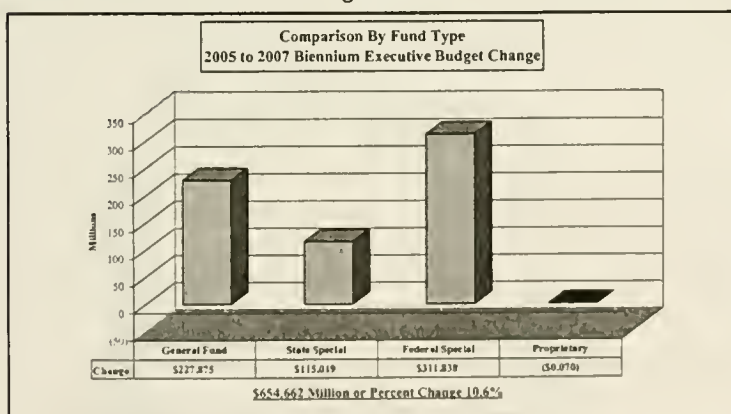


Figure 12



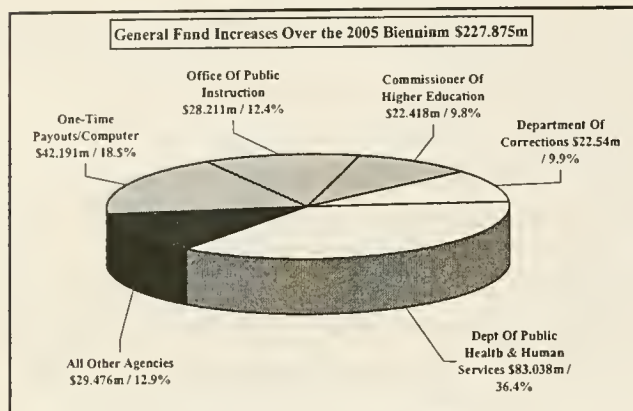
General Fund

General fund would increase by \$227.9 million, or 9.9 percent.

General fund continues to be a smaller percentage of the total state budget. However, the reduction in share is significantly smaller than in recent biennia because the Governor is proposing a percent increase in general fund only slightly less than the proposed percent increase in federal funds.

The Governor's proposed increase is dominated by five factors, which account for 84 percent of the increase, as shown in Figure 13 and discussed below.

Figure 13



- Human services increases \$83 million, or 16 percent. This increase is 36 percent of the total. The Governor:
 - Maintains services for recipients of various programs, most notably Medicaid, despite a reduction in the share of Medicaid (and other programs that are linked to the Medicaid match rate) that the federal government will pay
 - Adds funds for various expenses at the state institutions

- One-time payouts and computer development/enhancement account for over \$42 million, or almost 19 percent of the total.

The Governor recommends paying all remaining Crow Tribe and IRIS (DOR computer system) debt service obligations, totaling \$23.0 million. Computer development/enhancements add another \$19.1 million.

- K-12 Education would increase by \$28.2 million, or 2.7 percent. This increase, while minor against the \$1.1 billion biennial budget, is over 12 percent of the total increase. The Governor does not add any initiatives to address the recent school funding lawsuit rulings. Increases are inflationary adjustments to the Base Aid appropriation, and various other adjustments for programs such as special education, gifted and talented, school facilities, and vocational education.
- Corrections is \$24.1 million, or almost 10 percent of the increase. The Governor proposes to address rising populations by:
 - Adding private, contract beds in secure care and pre-release
 - Adding state FTE probation and parole officers
- Higher Education would increase by \$22.4 million, or 8 percent. The Governor has two priorities:
 - All enrollment increases and other operating costs are funded, and the share of general fund of these increases is increased to help reduce potential tuition increases
 - Almost \$10 million is added for Shared Leadership, which attempts to position the Montana University System as a driver of economic development, and for equipment purchases at the vocational technical schools

State Special Revenue

State special revenues would increase by \$115 million, or 11.6 percent.

- While most agencies receive funding from one or more state special revenue accounts, three areas of government account for over 85 percent of the increase.
- Department of Transportation increases by \$52.4 million, or 10.6 percent. Federal highway funds increase, and the Governor recommends matching the anticipated federal funds to ensure the most favorable matching rate.

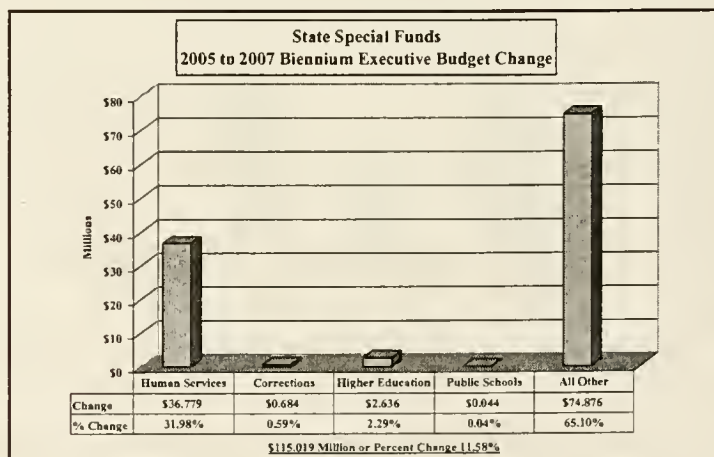


Figure 14

The Governor also adds funding for the Highway 93 project, which will be reimbursed by the federal government.

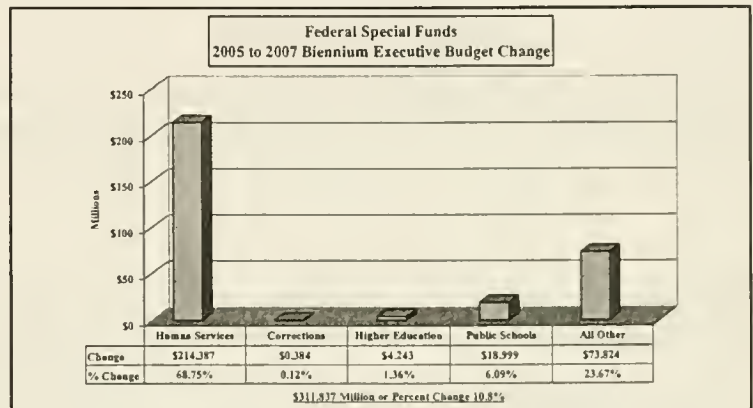
- Human services increases by \$36.8 million, or almost 43 percent. The Governor proposes to continue to divert tobacco settlement funds from tobacco prevention and control to other programs in the Department of Public Health and Human Services, and would continue the hospital provider tax and intergovernmental transfers used to match federal funds
- The Department of Fish, Wildlife, and Parks would be increased by \$8.8 million, or 13.4 percent. This increase is due to increases in state match for federal funds, as well as other initiatives

Federal Funds

Federal funds increase by 10.8 percent, or \$311.8 million.

- While both federal funds and increases are widely dispersed across state government, human services accounts for almost 70 percent of the total increase, while the Department of Transportation accounts for an additional 10 percent. One significant federal funding source not included in the 2007 biennium budget is homeland security grants to the Department of Military Affairs. Because of the uncertainty of the size and timing of Montana's grant, the Governor would leave this appropriation to the budget amendment process in the interim. For a further discussion of the issues of this exclusion, see the Department of Military Affairs on page D-172 in Volume 4.
- Significant changes in human services are due to:
 - Rising caseloads and service utilization, most notably in Medicaid and food stamps
 - Continued use of hospital provider tax, bed tax, and intergovernmental transfers to secure additional federal funds
 - Medicaid redesign, which uses proposed waivers to utilize current state funding to match additional federal funds
 - Anticipated increases in categorical grants
- The failure of Congress to pass a highway funding bill has made the level of federal funds the state will receive in the 2007 biennium uncertain. The budget assumes an increase from the 2005 biennium of \$30.5 million, based upon the average of the current House and Senate versions.
- The federal presence in K-12 education continues to grow. While still only a fraction of total expenditures in this area, federal funds increase by \$19 million, or 7 percent.

Figure 15





STATEWIDE EXECUTIVE BUDGET PROPOSALS/ISSUES

INTRODUCTION/HIGHLIGHTS

INTRODUCTION

This section discusses several stand-alone features of the executive budget that either do not pertain to any one agency, or which impact several agencies. These items are listed below and discussed in more detail in the following pages.

HIGHLIGHTS

- **Supplemental Appropriations – Fiscal 2005.** The executive's preliminary supplemental recommendation totals \$12.65 million general fund, with requests for district court expenditures, corrections, child support, and foster care dominating the total.
- **Executive Pay Plan Proposal.** The executive includes funding for a 3 percent per year salary increase beginning October 1 each year, and an increase in insurance contributions each year of \$46 per month for FY 2006 and \$51 per month for FY 2007. The Governor has included \$30 million general fund and \$28.5 million other funds for these increases.
- **FTE.** Total FTE would increase by 106.09 in FY 2006 and 91.16 in FY 2007 over the FY 2004 level. However, these increases are net of a number of increases and decreases, including statewide FTE reductions proposed by the Governor, targeting FTE funded with general fund.
- **Vacancy Savings.** The executive has applied a 4 percent vacancy savings rate to all personal services, including insurance contributions.
- **Pension Funds.** Pension funds in most states, Montana included, are experiencing significant unfunded liabilities due to investment losses. The state as employer is liable for the solvency of the funds. The executive budget includes over \$7 million general fund to address this issue.
- **Fee Changes.** The executive budget proposal includes changes in fees in two agencies, with the effect of increasing expenditures from other funds. The increase in other funds is \$3.7 million.
- **Fund Switches.** The executive has included a number of funding switches in the executive budget. Due to unique circumstances, the funding switches increase general fund expenditures by over \$7.0 million in the 2007 biennium.
- **One-Time Only Expenditure Proposals.** The executive proposes over \$94 million in one-time expenditures.
- **Executive New Initiatives (New Proposals).** The Governor proposes over \$118 million in general fund new initiatives (new proposals) in the 2007 biennium.
- **Fixed Costs.** Fixed costs increase by over \$7.7 million in the 2007 biennium over the 2005 biennium appropriations.

- **Inflation/Deflation.** Inflation or deflation was applied to 10 expenditure items for the 2007 biennium. Three were inflationary and 7 were deflationary. Natural gas experienced the largest increase.
- **Long-Range Planning Proposals.** The Governor's request for Long-Range Planning includes a total of \$197.2 million for capital projects, grants, and loans. Projects in the Long-Range Building Program make up the largest portion, with \$161.2 million. Only one other biennium (1997) in the last 10 biennia exceeded this amount. The portion of LRBP projects funded outright (not by GO bonds) is \$156.1 million, which is the most spent in this category. There is only one bonded project.

SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are used to increase existing spending authority for a fiscal year. The supplemental appropriations requested by the executive are for additional funding applicable to the current year, fiscal 2005. The original budget for fiscal 2005 was approved by the 2003 legislature.

Figure 1 shows supplemental appropriations since the 1987 biennium.

Figure 2 provides detail on the executive's \$12.7 million in requested general fund supplemental appropriations. As shown, funds are being requested for a number of agencies.

REQUESTED SUPPLEMENTAL APPROPRIATIONS

The following briefly discusses each request. The individual supplemental requests are discussed in more detail in the individual agency narratives in the *Agency Budget Analysis* section of the *Legislative Budget Analysis*, Volumes 3 and 4.

Judiciary

The Judiciary has two requests for supplemental appropriations.

1. District Courts - The Judiciary assumed responsibility for the oversight and administration of the 22 judicial districts in FY 2003. Expenses that had been funded by the counties prior to assumption are now funded from the general fund.

Figure 2

Supplemental Appropriation Requests Executive Budget - Fiscal 2005

Department/Program	General Fund	Other Funds
Judiciary		
District Court Costs	\$5,800,000	
Unfit to Proceed" Costs	1,000,000	
Corrections		
Increased Populations/Overtime	3,000,000	
Governor's Office		
Elected Official Payout	253,000	
Commissioner of Political Practices		
Elected Official Payout	9,620	
Justice		
Employee Payout	24,000	
Major Litigation	200,000	36,000
Highway Patrol Retirement Fund	363,762	
Public Health and Human Services		
Child Support Enforcement	857,058	
Foster Care	1,142,942	
Total	<u>\$12,650,382</u>	<u>\$36,000</u>

Figure 1

General Fund Supplementals 1987 to 2005 Biennia

Biennium	Millions
1987	\$32.7
1989	17.1
1991	20.4
1993	82.2
1995	19.9
1997	14.2
1999	11.5
2001	68.2
2003	12.5
2005	12.7

Expenditures significantly exceeded the appropriation throughout the biennium due largely to higher variable costs (those costs associated with caseload), particularly in indigent defense. These higher costs are expected to be ongoing, as the increase in variable costs was not due to any unique, or uniquely costly, cases.

2. Unfit to Proceed - Statute states that the district courts are responsible for the expense of commitment of defendants to Montana State Hospital under a district court order to determine the fitness of an individual to proceed in a criminal case against that individual. Montana State Hospital assumed these costs in prior years, but will now bill the Judiciary. The executive adds \$1.0 million for these costs. There is no net impact however, as a like amount will be deposited to the general fund.

Corrections

The Department of Corrections has experienced higher overtime costs and population growth (primarily in secure facilities) than anticipated by the 2003 legislature. The department received a portion of the personal services contingency fund appropriated by the legislature, and also used a portion of a biennial appropriation as an "advance" to avoid a supplemental appropriation in FY 2004.

Governor's Office/Commissioner of Political Practices

Supplemental requests have been submitted for termination pay for exempt employees in the office of the Commissioner of Political Practices and the Governor's Office. When an employee leaves state government, they are entitled to a payout of all annual leave up to a maximum level, and a portion of all sick leave balances. The term of the current commissioner of political practices expires in FY 2005 and payout is requested for all eligible balances. In addition, the Governor has a number of exempt staff (those who serve at the pleasure of the Governor) who will likely leave state service. The amount in the Governor's budget assumes payout of all eligible balances to all exempt employees. If certain exempt employees do not leave state service, this number will be refined. Please note that staff of the Secretary of State is paid from a non-appropriated proprietary fund, and no appropriation is required for any potential payouts. Other statewide elected officials were re-elected, and no significant staff turnover is expected.

Department of Justice

There are three requests for the Department of Justice:

1. Employee payout – This appropriation would fund the severance costs of a retiring long-time employee.
2. Legal services major litigation – The legislature provides a \$400,000 biennial general fund appropriation for the costs of major litigation. By their nature, these costs are unknown at the time of appropriation. Additional costs are associated with long-standing cases such as tobacco settlement maintenance, and other cases such as snowmobile, school distribution, and other issues.
3. Highway patrol retirement fund – Legislation passed by the 2003 legislature directed a one-time fee of \$1.25 per vehicle for the Montana Highway Patrol pension trust fund. However, sufficient authority was not provided to make the necessary transfer from the general fund to the account. This request would have no impact on the general fund, as the total amount was already assumed in the level of transfers anticipated from the general fund.

Department of Public Health and Human Services

The executive seeks supplemental appropriations for two programs.

1. Child Support Enforcement Division – This division derives its funding from three main sources.
 - When the division collects payments for a TANF recipient family, the division keeps a portion and a portion is returned to the federal government. These funds, along with federal matching funds, are used to fund the division
 - Federal incentive funds, which are received for meeting certain performance standards, are matched with additional federal funds
 - General fund has been appropriated to the division to supplement the other state and federal revenues

The 2003 Legislature also added tobacco settlement funds to supplement the division due to reduced TANF caseloads and the loss of a portion of the previously assumed level of incentive funds. These factors continue in the 2005 biennium, and the executive seeks a supplemental appropriation to offset losses in TANF collections and federal incentive revenues.

2. Foster care – The federal government shares in the cost of care for any child who enters the foster care system and meets the eligibility criteria contained in section IV-E of the Social Security Act. Because state costs of care are lowered whenever a child is determined IV-E eligible, the state pursues certification whenever possible. The number deemed eligible was recently reduced significantly from the number assumed when the appropriation was made due to two primary factors:
 - An internal audit by the department
 - Audits and tightening requirements by the federal government

As a result, the general fund must assume a greater percentage of the cost of care for more children. The total shortfall is estimated at \$3.7 million, with the remaining \$2.6 million mitigated with internal reductions.

FIRE COSTS

Montana does not appropriate funds for future fire costs. Instead, any costs incurred by state government (the Department of Natural Resources and Conservation and the Department of Military Affairs) are paid by the agencies as they become due, and the legislature then provides a supplemental appropriation to both pay all outstanding claims and to reimburse the agency[s] for any costs already paid. Consequently, each legislative session the legislature is asked to provide a supplemental appropriation to pay for all state costs of fighting fires in the current biennium. Although fire costs in FY 2005 were well below average, Montana had a severe fire season in FY 2004. Total costs over the biennium were almost \$84 million, of which over \$35 million was the responsibility of the state general fund. However, as shown in the Figure 3, the executive is not requesting any supplemental appropriation for fire costs in the 2005 biennium, a situation that, as shown in Figure 3, is unprecedented.

Figure 3
Supplemental Appropriations for Fire Suppression
1983 to 2005 Biennium

Biennium	Supplemental Appropriation	Statutory Appropriations	Total
1983	\$0.80	\$0.00	\$0.80
1985	2.90		2.90
1987	3.74		3.74
1989	12.64		12.64
1991	3.00	0.50	3.50
1993	7.94	1.96	9.90
1995	15.50	8.92	24.42
1997	4.47	3.10	7.57
1999	10.55		10.55
2001	33.22	6.20	39.42
2003	9.07	7.01	16.08
2005	0	0	0

The reason for this anomaly was the passage by Congress of the Jobs and Growth Tax Relief Reconciliation Act of 2003 in June 2003. One part of this act was a \$25 million per year (total \$50 million) grant to the state. This grant had very few requirements, and the Governor chose to set aside a significant portion for the costs of fighting fires. Given the mild FY 2005 fire season, funds set aside by the Governor for this purpose are sufficient to pay all current and anticipated fire costs in the 2005 biennium. Without this grant, the supplemental request proposed by the executive would have been higher by a like amount. A further discussion of the Jobs and Growth Tax Relief Reconciliation Act of 2003 begins on page 134 of this report.

EXECUTIVE PAY PLAN PROPOSAL

While the executive has not completed a negotiated state employee pay plan, a request for funding for a pay plan increase is included in the executive budget.

The executive has submitted legislation for a pay plan for the 2007 biennium in two primary parts:

- An increase in per employee insurance contributions of \$46 per month beginning January 1, 2006 and an additional \$51 per month beginning January 1, 2007. The same increases are applied to the university system employees beginning July 1 of each year
- A 3 percent per year salary increase beginning October 1 each year

The executive is also recommending that the legislature fund a personal services contingency for distribution to agencies that cannot meet vacancy savings targets and a small training allowance. With the exception of insurance contributions, which are fully funded, the executive applies a 4 percent vacancy savings rate to the funding calculations.

The legislation includes the following appropriations (detailed in Figure 4):

- \$31.5 million general fund and \$31.5 million other funds (\$63.0 million total funds) for the pay plan and insurance increase
- \$1.5 million general fund and \$3.0 million other funds for a personal services contingency
- \$75,000 general fund for a training allowance

Figure 4
Proposed Pay Plan Appropriation - Executive Budget
2007 Biennium

Entity	--- Fiscal 2006 ---			--- Fiscal 2007 ---			--- 2007 Biennium ---		
	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
Legislative Branch	\$177,219	\$15,802	\$193,021	\$444,838	\$39,532	\$484,370	\$622,057	\$55,334	\$677,391
Consumer Counsel	0	10,254	10,254	0	25,342	25,342			0
Judiciary	520,470	18,381	538,851	1,303,340	45,957	1,349,297	1,823,810	64,338	1,888,148
Executive Branch	4,662,443	7,938,840	12,601,283	11,907,644	20,096,049	32,003,693	16,570,087	28,034,889	44,604,976
University System	3,360,580	108,790	3,469,370	7,592,508	241,249	7,833,757	10,953,088	350,039	11,303,127
Total	\$8,720,712	\$8,092,067	\$16,812,779	\$21,248,330	\$20,448,129	\$41,696,459	\$29,969,042	\$28,504,600	\$58,473,642
Training Allowance*	\$75,000		\$75,000				\$75,000	\$0	\$75,000
Personal Services Contingency*	1,500,000	3,000,000	4,500,000				1,500,000	3,000,000	4,500,000
Total Proposed Appropriation	<u>\$10,295,712</u>	<u>\$11,092,067</u>	<u>\$21,387,779</u>	<u>\$21,248,330</u>	<u>\$20,448,129</u>	<u>\$41,696,459</u>	<u>\$31,469,042</u>	<u>\$31,504,600</u>	<u>\$62,973,642</u>

*Biennial appropriations

In addition, the executive is proposing to combine the current teachers' and blue-collar pay classifications into the primary state pay classifications.

INSURANCE INCREASE

The employer contribution to the health insurance costs of employees is increased 10 percent each year, to \$506 per month beginning January 1, 2006, and to \$557 per month beginning January 1, 2007 or most state employees. University system increases are effective July 1 of each year.

**LFD
ISSUE**

In determining the level of premium for employee health insurance, a \$10 per month reserve component was not included, as has occurred in the past. The reserve amount would provide a buffer in the event actual claims exceed projections. In the past, this \$10 reserve was incorporated into the state contribution toward the premium amount each month. Without the reserve, and with unpredictable claims activity, there is increased risk that adjustments to the health insurance plan may need to occur during the biennium to maintain its fiscal solvency. The burden created by any adjustments due to higher than projected claims activity would fall on the employee through increased premium, higher deductibles, or higher co-pays.

SALARY INCREASE

The executive proposes to increase state employee salaries by 3 percent each year of the biennium, beginning on October 1.

FUTURE COSTS

Because the pay and insurance increases are phased in over the biennium, costs in the next biennium for this pay plan will be significantly higher - \$48.8 million general fund and \$97.4 million other funds (excluding positions for which the legislature does not appropriate funds).

PERSONAL SERVICES CONTINGENCY

The executive is proposing a contingency pool of \$1.5 million general fund and \$3 million other funds. The funds would be allocated by the Office of Budget and Program Planning to agencies when personnel vacancies do not occur, retirement costs exceed agency resources, or other contingencies arise.

The legislature has appropriated funds for this purpose for several biennia.² In the 2005 biennium, the legislature appropriated \$1.5 million general fund and \$3.0 million other funds as a contingency. A total of \$450,049 general fund and \$633,132 other funds had been spent from the contingency as of the writing of this report. The largest recipient of the funding was the Department of Corrections, which received \$300,000 general fund and \$606,256 other funds. The institutions in the Department of Public Health and Human Services received funding from the temporary federal Jobs and Growth Tax Relief Reconciliation Act of 2003 to reduce vacancy savings.

OTHER ISSUES

Military Deployments

Numerous Montana state employees who are also members of the national guard or other reserve units, have been called to duty for periods often times in excess of one year and for as long as two or more years. From a state fiscal perspective, there are potential impacts that need to be kept in mind relative to the budget. While there might be an expectation of increased vacancy savings for individual

² For a complete history of vacancy savings assumptions and contingency appropriations, see the Vacancy Savings narrative in this volume.

agencies, this is not necessarily the case, as agencies tend to fill these positions with temporary replacements. Many positions fall into the category of being "24/7" coverage positions, and agencies cannot afford to leave them vacant. Therefore, a decrease in costs resulting from the deployments is not necessarily a reliable expectation.

On the other hand, when a deployed soldier returns, he or she has certain rights that might increase costs for state agencies. Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), for example, a returning soldier can purchase the service time that he or she would have earned if working. If that employee pays the cost of his or her share of the retirement costs, then the state as employer must pay its cost. There is no way to anticipate how many returning soldiers will do this, but the potential is there.

Costs can vary in other ways also. Temporary replacements would typically be hired at entry rates, so costs might be lower. On the other hand, if a replacement is not found, overtime costs might come into play, resulting in higher costs.

Broadbanding

The state is facing major challenges in the area of human resources in the short and long-term. The state government workforce is aging, and a significant percentage of state employees, representing many years of experience, are nearing retirement age. At the same time, the number of workers to take their place is not keeping pace. The state faces the real possibility not only of a great loss of expertise, but of having to replace those experienced workers with less experienced personnel at salary levels that reflect high demand.

In part as a means of addressing this reality, the state has embarked upon a means of classifying and paying personnel called a broadband pay plan, which is part of a larger human resource classification and pay initiative called the Montana Human Resources Competency Project. Instead of employees being in one of a number of narrowly defined "bands" for purposes of determining pay, the bands are widened to allow greater flexibility to managers to adjust duties and pay within the band. Certain agencies have made conversions to broadbanding for significant numbers of employees. The executive has stated it has a tentative timetable to move all state employees to a broadband pay system by the end of the 2007 biennium.

The initial banded pay plan was implemented in part because of concerns that employees with similar skills and responsibilities were being paid at significantly different levels among agencies of state government. In part in order to increase equity, the legislature originally established a pay plan with fairly narrow pay bands and specific job requirements. While broadbanding allows for greater flexibility, particularly in those positions with specialized, high demand skills where recruiting and retaining employees is an issue, broadbanding can also have equity consequences within state government that the initial pay plan was in part implemented to address.

- In order to be effective, there must be funding to implement and maintain broadbanding over time. Therefore, an agency's ability to use broadbanding to best effect may be limited by funding. Agencies with little or no general fund and/or stable non-general fund sources of funding (state special, federal, and proprietary revenue) will be at an advantage over agencies with either significant general fund and/or a more limited non-general fund source of funding

- Some agencies have more funding flexibility than others, and could conceivably use broadbanding more effectively. This situation not only creates inequities between and among agencies, it can actually increase turnover in agencies that cannot compete in salaries with other agencies

In addition, with broadbanding the legislative pay plan is a major but potentially ever smaller part of the determination of how much a state employee is paid. While the pay plan is still an extremely important determinate of most state employees' wage adjustment (and all of the insurance adjustment), a greater share of personal services is determined outside of the direct legislative appropriations process.

The legislature may wish to examine broadbanding more thoroughly during the interim to address these and other questions:

- How is broadbanding impacting the state's ability to recruit and retain employees
- How does the administration plan to address the actual and potential fairness issues among agencies of state government as broadbanding becomes the norm--can broadbanding be made more equitable among agencies both as a general employee fairness issue, and to reduce other issues of recruitment and retention between and among agencies
- How can the pay plan addressed by each legislative session more effectively take into account broadbanding and its effect on pay levels
- What impact is broadbanding having on the state personal services budget

Medical Cost Increases

All state governments, and Montana is no exception, deal with the impact of rising medical costs. Nationally, it is estimated that 10 percent of state expenditures are for medical costs, which include payments for state employee health benefits, Medicaid services, state Children's Health Insurance Programs (CHIP), and medical services provided by and paid for by state institutions. The legislature may wish to study whether there is a way for state funded health services to either be combined or to learn from each plan's cost control methods for Montana to realize savings.

PERSONAL SERVICES ISSUES

Personal services represents the costs of salaries and benefits for state employees, and represents nearly 40 percent of total state agency operating costs (excluding grants and benefits, capital outlay, and transfers). The following discussion addresses two major components of personal services, total FTE and Vacancy Savings.

FTE IMPACTS

The proposed executive budget will have an impact on the number of state government FTE (full-time equivalent employees). As shown in Figure 5, total FTE would increase over the FY 2004 level by 106.09 in FY 2006 and 91.16 in FY 2007 (reduction of 14.93 from FY 2006).

Figure 5					
Total Proposed FTE Levels					
2007 Biennium Executive Budget					
Section/Agency	Base Fiscal 2004	Net Change Fiscal 2006	Total Fiscal 2006	Net Change Fiscal 2007	Total Fiscal 2007
Section A*					
Legislative Branch**	124.77	0.20	124.97	5.37	130.14
Consumer Counsel	5.04	0.00	5.04	0.00	5.04
Judiciary	374.68	(12.55)	362.13	(12.55)	362.13
Governor's Office	60.00	(0.43)	59.57	(0.43)	59.57
Commissioner of Political Practices	5.00	(1.00)	4.00	(1.00)	4.00
State Auditor	71.50	2.00	73.50	2.00	73.50
Transportation	2,176.13	54.28	2,230.41	29.15	2,205.28
Revenue	609.53	2.55	612.08	2.50	612.03
Administration	151.07	6.65	157.72	6.65	157.72
Appellate Defender	3.00	0.00	3.00	0.00	3.00
Consensus Council	2.00	0.00	2.00	0.00	2.00
Section B					
Public Health and Human Services	2,755.01	(25.83)	2,729.18	(15.83)	2,739.18
Section C					
Fish, Wildlife, Parks	623.44	30.36	653.80	21.53	644.97
Environmental Quality	355.03	19.50	374.53	19.50	374.53
Livestock	145.49	(10.50)	134.99	(10.50)	134.99
Natural Resources and Conservation	486.24	4.00	490.24	4.00	490.24
Agriculture	111.54	2.00	113.54	2.50	114.04
Commerce	47.00	(5.34)	41.66	(5.34)	41.66
Section D					
Public Service Commission	39.00	0.00	39.00	0.00	39.00
Crime Control	19.00	2.00	21.00	2.00	21.00
Justice	710.60	(1.63)	708.97	(2.77)	707.83
Corrections	1,095.05	10.70	1,105.75	14.70	1,109.75
Labor/Industry	707.48	6.60	714.08	6.60	714.08
Military Affairs	168.90	5.00	173.90	5.00	173.90
Section E					
Office of Public Instruction	125.31	5.35	130.66	5.90	131.21
Board of Public Education	4.00	0.00	4.00	0.00	4.00
MT. School for the Deaf and Blind	81.68	(0.73)	80.95	(0.73)	80.95
Commissioner of Higher Education***	90.05	12.00	102.05	12.00	102.05
Arts Council	7.00	0.00	7.00	0.00	7.00
State Library	28.50	1.00	29.50	1.00	29.50
Historical Society	57.68	(0.09)	57.59	(0.09)	57.59
Totals	11,240.72	106.09	11,346.81	91.16	11,331.88

*Secretary of State FTE are all supported with proprietary funds.

**FY 2007 includes session staff.

***Includes only staff from the Commissioner of Higher Education office.

These increases are the net of a number of proposed increases and decreases in FTE.

Major Increases

The following summarizes the major increases in FTE recommended by the Governor. For a further discussion, see the individual agency narratives in Volumes 3 and 4 of the Budget Analysis.

- Montana Department of Transportation – FTE are added or subtracted in conformance with the construction plan for any given biennium, this increase primarily reflects increased construction and engineering activity anticipated in the 2007 biennium
- Department of Fish, Wildlife, and Parks – FTE would increase in significant part due to a conversion of the automated licensing system from contracted services to in-house FTE, and to miscellaneous new initiatives
- Department of Environmental Quality – FTE would increase for two reasons:
 1. To provide additional staff for the total maximum daily load (TMDL) project as the court ordered deadline approaches; and
 2. To provide assistance in numerous functions with current workload issues
- Department of Corrections – FTE staff increase due to an increase in probation and parole staff. (Most cost increases in the department are in contract facilities such as pre-release centers and the private and regional prisons, rather than through the addition of state FTE)
- Office of Public Instruction – FTE would increase due to increases in projects/programs funded by federal grants
- Commissioner of Higher Education (Montana University System) – FTE in the commissioner's office increase due to increased activity in the Guaranteed Student Loan Program, and the addition of staff to support the Shared Leadership Project initiatives

Major Reductions

There are three main reductions included in the totals.

- Judiciary – The primary cause of the net reduction in the Judiciary is due to the sunset of statute authorizing a surcharge of \$10 on case filings in courts of original jurisdiction, which had funded information technology initiatives in Montana courts. As of this writing, the Judiciary planned to request that the legislature fund this function with general fund. For a further discussion, see the Judiciary narrative in Volume 3, page A-28.
- Department of Livestock - The Department of Livestock is primarily funded with revenue from assessments on livestock. As the number of livestock have declined, so has revenue to operate the department, resulting in a reduction of FTE. For a further discussion, see the Department of Livestock narrative in Volume 4, page C-89.
- Statewide FTE Reductions - The 2003 Legislature imposed an additional, cumulative vacancy savings rate of about 2 percent on general funded positions as a budget saving measure. Because the legislature did not identify any positions associated with the reduced vacancy savings, all 2005 biennium reductions were fully funded in the 2007 biennium initial budget determination. With limited exceptions, agencies with FTE supported with general fund and under the jurisdiction of the Governor (as well as the Judiciary) are reduced in the 2007 biennium executive budget by an amount equivalent to the prior reduction in order to make those reductions permanent. These reductions total 55.00 FTE in the executive branch and 5.00 FTE in the Judiciary.

Statewide FTE Reduction

The legislature does not “approve” or “disapprove” the level of FTE in each agency. Rather, the legislature determines which FTE will be funded in the current biennium, and which can be used to determine present law personal services in the next biennium. Therefore, the number of FTE is a very important part of budget determination. As stated, the Governor proposes to permanently remove some FTE from current and future personal services budget determination as a means to make the 2005 biennium budget reduction permanent.

Figure 6 details the statewide personal services adjustment and FTE reduction recommended by the Governor, by agency. As shown in the figure, several agencies were exempt. The exemptions were generally due to four conditions:

- Legislative branch because the Governor must accept the budget as submitted due to separation of powers issues
- Agencies with a small number of FTE
- Agencies that took the initial 2005 biennium reduction in operating expenses, meaning that the 2005 biennium reduction carried forward into the 2007 biennium
- Other miscellaneous exemptions

Reductions imposed on the agencies shown in the figure essentially mirror the general fund reduction enacted by the 2003 Legislature, with two major exceptions: 1) the Department of Public Health and Human Services; and 2) the Department of Corrections. The 2003 Legislature calculated the reduction based upon an average cost per FTE across agencies, rather than within each agency. As a result, agencies with an overall lower average salary, such as DPHHS and corrections, had a generally higher overall percentage reduction than agencies with an overall higher average salary. In addition, agencies with positions that had to be filled 24 hours a day, 7 days a week were not exempted from the 2005 biennium reduction. The Governor has adjusted the reduction in the 2007 biennium primarily to recognize the 24/7 positions.

Figure 6

Statewide FTE Reductions 2007 Biennium Executive Budget

Section/Agency	Biennial FTE Reduction	Biennial General Fund Reduction	Percent FTE Reduction	Additional General Fund Reduction
Section A*				
Legislative Branch	0.00	\$0	---	---
Consumer Counsel+	0.00	0	---	---
Judiciary	5.00	510,916	1.3%	1.2%
Governor's Office	0.79	85,875	1.3%	1.2%
Commissioner of Political Practices**			---	---
State Auditor+	0.00	0	---	---
Transportation+	0.00	0	---	---
Revenue	9.50	871,318	1.6%	1.8%
Administration	1.50	117,788	1.0%	0.7%
Appellate Defender	0.00	0	---	---
Consensus Council+	0.00	0	---	---
Section B				
Public Health and Human Services	29.03	1,613,571	1.1%	0.6%
Section C				
Fish, Wildlife, Parks+	0.00	0	---	---
Environmental Quality	1.00	83,724	0.3%	0.2%
Livestock	0.00	0	---	---
Natural Resources and Conservation	0.00	0	---	---
Agriculture	0.00	0	---	---
Commerce***	0.34	27,959	0.7%	0.6%
Section D				
Public Service Commission+	0.00	0	---	---
Crime Control	0.00	0	---	---
Justice	4.52	491,410	0.6%	0.7%
Corrections	4.30	438,684	0.4%	0.5%
Labor/Industry	0.40	38,201	0.1%	0.1%
Military Affairs	0.00	0	---	---
Section E				
Office of Public Instruction	1.55	97,403	1.2%	0.7%
Board of Public Education	0.00	0	---	---
MT. School for the Deaf and Blind	0.73	62,587	0.9%	0.8%
Commissioner of Higher Education****	0.50	45,074	0.6%	0.5%
Arts Council	0.00	0	---	---
State Library	0.00	0	---	---
Historical Society	0.84	52,696	1.5%	1.0%
Totals	60.00	\$4,537,206	0.5%	0.4%

*Secretary of State FTE are all supported with proprietary funds.

**Part of a larger reduction due to an extended vacancy.

***Does not include 3.0 FTE reallocated to a statutory appropriation

****Includes only staff from the Commissioner of Higher Education office.

+No general fund in the agency

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Some agencies have preliminarily identified which positions would be targeted while others have not. In addition, the FTE identified for elimination may not coincide with legislative priorities. The legislature may wish to examine the reductions proposed in each agency during budget deliberations to determine:

- What services, if any, would be reduced
- What impact the reduction might have on expenses in other areas of state government or within the individual departments, or on other governmental entities
- Whether reduction of the FTE would have any impact on the receipt of federal funds, or on state revenue collections
- What other reduction options may be possible

VACANCY SAVINGS

Vacancy Savings is the difference between the cost of fully funding a position for the entire year and the actual cost of authorized employee positions during that period. A vacancy savings reduction, usually a percentage reduction from full funding, has been applied to budgets in prior years in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than appropriated. This section outlines the executive's proposal for vacancy savings.

Executive Proposed Vacancy Savings

The executive has applied a 4 percent vacancy savings rate to all personal services including insurance contributions. The rate is applied to all positions in state government with the following exceptions.

- Agencies with fewer than 20 FTE
- University system faculty
- Elected officials
- The legislative branch
- The judicial branch

The executive has applied vacancy savings to on-going positions and those proposed for inclusion by present law adjustments or new proposals. Vacancy savings reductions total \$49 million over the 2007 biennium, of an estimated impact of \$19.1 million is general fund. Of the \$49 million, \$40.2 million is from state government (excluding the university system) and \$8.8 million is from the university system.

Personal Services Contingency

In order to assist agencies that have insufficient authority to meet all personal services costs in the 2007 biennium, the executive is proposing, in the pay plan bill, a contingency fund including \$1.5 million general fund and \$3.0 million other funds. Agencies experiencing this problem would have to apply to the Office of Budget and Program Planning for these funds during the biennium.

PENSION FUND - UNFUNDED LIABILITIES

EXECUTIVE RECOMMENDATIONS

The most recent actuarial valuations of the state pension funds were completed for the period ending July 1, 2004, and have determined that the plans have unfunded liabilities that exceed the statutory 30-year amortization period for funding. The current unfunded liabilities are primarily due to market losses on the investment of pension funds. Pension funds in most states are experiencing significant unfunded liabilities due to investment losses. The state as employer is liable for the solvency of the funds.

The executive recommends legislation to actuarially fund various public employee retirement systems. An estimate in the executive budget of \$7.2 million general fund for the biennium would fund the first of a two-biennium phase-in of state contribution increases for the retirement systems for public employees (PERS), teachers (TRS), game wardens and peace officers (GWPORS), and sheriffs (SRS). The state contribution increases, along with system design changes that would impact employees hired after July 1, 2005, are proposed to address significant unfunded liabilities of the plans.

Public Employees' Retirement Systems

Executive recommendations to address the unfunded liabilities of plans under the Public Employees' Retirement Board (PERB) include the employer contribution increases shown in Figure 7 and system design changes. System design changes include the following for workers hired after July 1, 2005:

- Change the definition of final average salary from a 3-year to a 5-year average
- Cap the guaranteed annual benefit adjustment at the consumer price index for urban wage earners and workers (it is currently 3 percent)

Figure 7 Public Employee Retirement Board Employer Contribution (percentage of total employee compensation)			
Plan	Current Rate	New Rates	
		2007 Biennium	2009 Biennium
PERS	6.9	7.56	8.23
GWPORS	9.0	10.20	11.40
SRS	9.5	9.74	9.74

LFD COMMENT

Subsequent to the executive budget being released, the PERB has approved the employer contribution increase, but withdrawn the plan changes mentioned above for workers hired after July 1, 2005. The legislation (LC 96) to actuarially fund the plans under the PERB reflects the decisions of the board.

Estimates based on FY 2004 expenditures and funding indicate a \$2.5 million general fund impact in the 2007 biennium. Because the employer contribution increases are phased in over two biennia, the impact would be doubled in the 2009 biennium and remain at that rate each biennium thereafter, until the provision included in the legislation allows the PERB to lower the contribution rate to the current level (after an actuarial valuation determines the period required to amortize the system's unfunded liabilities is less than 25 years).

**LFD
COMMENT**

The actuarial valuation used to determine the recommended contribution increases indicate that the increases would only continue for three biennia before the unfunded liabilities are less than the 25-year amortization period and the rates can be returned to their current levels.

The general fund impact for the 2009 biennium would be an additional \$2.5 million above the 2007 biennium increase. Once the full rate increase is implemented, the \$5.0 million increase above the current biennium would continue for each biennium until the rate is returned to the current level and the unfunded liabilities are reduced to within the 25-year amortization period.

Teachers' Retirement System

Recommendations to address the unfunded liabilities of plans under the Teachers' Retirement System Board (TRB) include the employer contribution increases of shown on Figure 8 and system design changes. System design changes include the following for workers hired after July 1, 2005:

- Change the definition of final average salary from a 3-year to a 5-year average
- Change the normal retirement age for those with 5 or more years and who have attained the age of 60, from 25 to 30 years of service
- Change the early retirement age for those with 5 or more years of service from 50 to 55 years

Estimates based on FY 2004 expenditures and funding indicate a \$4.4 million general fund impact in the 2007 biennium. As with the PERS increases, the employer contribution increases are phased in over two biennia. As such, the impact would be doubled in the 2009 biennium and remain at that level of increase above the current contribution level for each biennium thereafter, until the provision included in the legislation (LC 100) determines the period required to amortize the system's unfunded liabilities is less than 25 years and the TRB lowers the contribution rate back to the current rate.

Figure 8
Teachers' Retirement Board
Employer Contribution
(percentage of total employee compensation)

Plan	Current Rate	New Rates	
		2007 Biennium	2009 Biennium
TRS	7.47	8.67	9.87
University system optional retirement program	4.04	4.60	5.16

**LFD
COMMENT**

The general fund impact for the 2009 biennium would be an additional \$4.4 million above the 2007 biennium increase. Once the full rate increase is implemented, the \$8.8 million increase above the current biennium would continue for each biennium until the unfunded liabilities are reduced to within the 25-year amortization period and the rate is returned to the current rate.

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Impacts of Member Demographics

The most recent actuarial valuation indicates that the average annual salary, age, and years of service for active members continue to increase from previous actuarial valuations. At the same time, the total number of contributing members has declined since the 2002 valuation. The legislature may want to ask how an aging workforce with higher termination salaries would impact plan costs, contributions, and future funding of liabilities when the current workforce is replaced with a younger workforce potentially earning lower salaries.

FEE CHANGES

Fee changes are often proposed by the executive as a means to do either of the following:

- Shift all or a part of the cost of functions from one funding source to another. These shifts can be done in order to ensure that those receiving the service are the persons paying for it, or a re-examination of the relationship between those who currently pay and the service; and/or
- Provide additional resources either to meet rising costs, address lower revenues, or begin new initiatives.

EXECUTIVE RECOMMENDATION

In the 2007 biennium, the executive proposes five fee changes in HB 2.

Figure 9
Fee Increases
Executive Budget
2007 Biennium

Agency/Program	--- General Fund ---		--- Other Funds ---		Explanation
	2006	2007	2006	2007	
Administration			\$1,400,833	\$1,401,336	Increased fees for recording land transaction documents by \$1 per page to develop a standardized, sustainable method to collect, maintain, and disseminate information in digital formats about the natural and man-made land characteristics of Montana (LC 79)
Justice	158,000	159,000			Fees for pathology services in the Forensic Science Division
DEQ/Permitting			166,732	157,278	Increased fees for hardrock mines. \$500 application, \$100 for renewal/exploration \$100 application, \$50 renewal
DEQ/Permitting			23,350	23,350	Septage fees increased to \$250 (HB77)
DEQ/Centralized Serv.			250,000	250,000	Increase in Montana Environmental Policy Act fees for environmental impact statements (LC1309)
Total	<u>\$158,000</u>	<u>\$159,000</u>	<u>\$1,840,915</u>	<u>\$1,831,964</u>	

The list above does not include one additional change proposed in the executive budget.

- The Judiciary would add state staff for remediation work currently done by private entities, and charge the parties involved for the service. General fund of \$218,159 is included in the budget to fund the positions, and any revenues collected would be deposited to the general fund.

The following fee related issues are also noted for informational purposes.

- The Department of Fish, Wildlife, and Parks has proposed increases in resident conservation license fees. Governor Martz has authorized the department to request the increase, but the submitted budget does not incorporate any increased revenues into the totals requested.
- The Law Enforcement Academy in the Department of Justice is funded with a surcharge of \$10 made by the courts of limited jurisdiction on certain criminal convictions. Funds were not collected at the level anticipated and the department has indicated it may seek an increase in fees.
- The Board of Livestock has increased certain fees to producers in an attempt to maintain collection levels for fees that fund most operations of the Department of Livestock. Because the fees are based upon head of livestock and most livestock counts are decreasing, revenues to fund the department are also decreasing.

- The executive budget includes a number of increases for ongoing operational expenses of the Montana University System. These expenses are funded with state appropriations (general fund, 6 mill levy, and minor other), and with non-appropriated tuition. In addition, the executive is proposing a pay plan that would include the Montana University System and be partially funded with tuition. Tuition is a user fee for students, and any increase in tuition is a fee increase. The executive funded the on-going operational increases with a greater share of general fund than the historical level, with the goal of reducing potential tuition increases. The executive has stated that it anticipated a tuition increase of no more than 2 percent would be needed to fund the proposed increases. The Montana University System at the November Board of Regents meeting estimated tuition increases of over 4 percent each year to fund the executive budget.
- Court automation costs in the Judiciary are funded with a surcharge of \$10 on filings in courts of original jurisdiction. This surcharge was increased from the historical \$5 by the 2003 Legislature to provide additional funds for the court automation effort, and expires at the end of the 2005 biennium. This would represent a fee decrease. The Judiciary is requesting that court automation be funded with general fund in the 2007 biennium. For a further discussion, see page A-28 in Volume 3.

FUND SWITCHES

The executive has included a number of funding switches in the executive budget. Due to unique circumstances, the funding switches increase general fund expenditures by over \$7.0 million in the 2007 biennium, as shown in the Figure 10.

Figure 10
Fund Switches
Executive Budget
2007 Biennium

Agency/Program	--- General Fund ---		--- Other Funds ---		Explanation
	2006	2007	2006	2007	
University System	\$2,660,000	\$2,660,000	(\$2,660,000)	(\$2,660,000)	Funding of various increases with 80 percent general fund, rather than historical 43 percent
Labor and Industry	613,665	611,535	(613,665)	(611,665)	Replace employment security funds with general fund for various programs
Judiciary	112,396	105,763	0	0	Supreme Court to hire 1.50 FTE for appellate mediator services currently being accomplished by private sector
Justice	61,503	61,430	(61,503)	(61,430)	1.00 FTE Chemist federally funded position to be funded with general fund due to expiration of federal grant
Justice	61,503	61,430	(61,503)	(61,430)	1.00 FTE Serologist/DNA federally funded position to be funded with general fund due to grant expiration
Total	\$3,509,067	\$3,500,158	(\$3,396,671)	(\$3,394,525)	

University System - The legislature appropriates general fund and six-mill levy revenue for a portion of the general operating expenses of the Montana University System, with tuition making up the bulk of the difference between the legislative appropriation and total expenditures. The Governor has recommended a higher level of general fund for recommended increases for statewide present law adjustments and enrollment increases than historically utilized. The Governor's stated goal is to minimize tuition increases. For a further discussion, see the Montana University System narrative in Volume 4 of the Legislative Fiscal Division Budget Analysis, page E-129.

Labor and Industry - The 2003 Legislature temporarily replaced general fund in several programs in the Department of Labor and Industry with employment security account (ESA) funds. ESA funds are derived from an assessment on all employers in the state. The funds were made available due to the one-time allocation to the state of additional federal funds, which replaced ESA funds in several programs, which then freed up the ESA. While the 2003 Legislature had made the allocation temporary, all uses fall within statutory guidelines and the ESA could continue to fund several of these programs. The executive budget, however, recommends returning support for some programs to the general fund. For a further discussion, see the Department of Labor and Industry narrative in Volume 4 of the Legislative Fiscal Division Budget Analysis, page D-121.

Judiciary - The executive is requesting general fund for the biennium to hire 1.50 FTE to provide mediation services. These FTE would select which appeals to mediate in order to reduce the number of mediations and improve the overall success rate. Further, parties to those cases selected for mediation would be required, as they presently are, to share the mediator's costs. This function is currently provided entirely by the private sector.

Justice - The executive is requesting general fund to hire 1.00 FTE as a chemist in the Forensic Science Division of the Department of Justice. This FTE would keep the current number of chemists at four, as this FTE would replace with general fund a position that is currently funded with federal funds that expire on June 30, 2005. The executive is also requesting general fund for 1.00 FTE Serologist/DNA. This position would keep the current number of serologists at four, as it changes the funding of 1.00 FTE to general fund from the current federal funds, which expire on June 30, 2005.

A major change in funding is not included in Figure 10 because it is not considered a traditional fund switch, but which has a significant impact, is in the Department of Public Health and Human Services (DPHHS), and is due to two factors that impact the percentage of total Medicaid benefit costs the state will pay. The combined impact is to increase general fund by \$55 million over the biennium and reduce federal funds by a like amount.

1. The federal government adjusts the federal Medicaid match rate each year based upon Montana's income growth compared to the national average. Because Montana's rate exceeded the national average, the percentage of Medicaid benefits costs the federal government will pay has gone down. As a result, in order to provide the same level of service, the general fund must be increased.
2. In FY 2003, as part of the provision of fiscal relief to states, the federal government increased the federal participation match rate for a portion of FY 2003 and all of FY 2004. Therefore, FY 2004 expenditures for Medicaid reflect the temporary fiscal relief. If the state provides the same level of services, the general fund must replace this reduced federal funding.

Each proposed funding switch is discussed in more detail in the individual agency narratives in Volumes 3 and 4.

ONE-TIME EXPENDITURES

The executive proposes over \$94 million in one-time expenditures. This is an unusually high amount of one-time proposals, and reflects the Governor's priorities for using one-time revenues from a high beginning general fund balance for one-time purposes, in order to maintain structural balance in the general fund. These one-time expenditures are in HB 2, other legislation, and proposed transfers as noted in Figure 11. The following details each of the proposed increases, using the categories noted by the executive.

Figure 11 One-Time Only Expenditures Executive Proposal - 2007 Biennium (Dollars in Millions)				
Expenditure Description	Biennial Amount	In HB 2?	HB 2 Agency	Analysis Page #
<u>Pay Off Debts</u>				
Pay off the Dept of Revenue computer system (IRIS phase 1 & II)	\$16.00	Y	Revenue	A-152
Replace Cultural Trust revenue used to buy Virginia/Nevada Cities	3.91	N	---	---
Completing payments for the Crow Tribe Water Compact Agreement*	7.00	Y	DNRC	C-142
<u>Deferred Maintenance & Other Capital Needs</u>	30.00	N	---	Section F
<u>Investment in Information Technology Infrastructure</u>				
Completion of POINTS computer system replacement	4.00	Y	Revenue	A-152
Computer system to track offenders	1.60	Y	Corrections	D-81
Property tax system replacement	5.50	Y	Revenue	A-173
Judiciary computer system completion	1.35	Y	Judiciary	A-28
Gambling Control computer system	1.10	Y	Justice	D-22
<u>Preparing for the Future</u>				
Northern Tier Emergency Telecommunications Infrastructure completion	4.10	Y	Administration	A-218
Dept of Revenue protested property tax reserve	4.00	N	---	---
Agricultural land reevaluation	1.40	Y	Revenue	A-173
Shared Leadership	3.94	Y	University System	E-132
<u>Equipment Needs</u>				
Equipment for two year programs	5.00	Y	University System	E-134
<u>Other</u>				
License plate issue manufacturing costs	4.35	Y	Corrections	D-104
Total Maximum Daily Load (TMDL) completion	0.33	Y	Environmental Quality	C-53
Pay federal government for workers' compensation transfer	0.22	N	Administration	A-178
Audiology equipment	0.17	Y	Office of Public Instruction	E-11
Purchase helicopter	0.20	Y	DNRC	C-156
Miscellaneous other computers, security, phones, grants, studies	0.34	Y	Various	---
Total One-Time Only Expenditures**	<u>\$94.50</u>			
*The Governor lists this increase as \$9.0 million. However, \$2.0 million is removed from the base for a total net of \$7.0 million				
**Governor lists an additional \$2.0 million. Difference is the Crow Tribe net noted above.				

Each of the proposed HB 2 increases is discussed in further detail in the appropriate agency narrative in either Volume 3 or Volume 4, as referenced in the far right column in the above figure. The property tax reserve is discussed on page 125 and the transfer to the cultural trust and the deferred maintenance and other capital needs proposal are discussed on page 102. In addition, the following are noted regarding these proposals.

1. The payment to the federal government for refunded workers' compensation transfers may not be necessary. For a further discussion, see page A-178 in Volume 3.
2. A re-engineering effort may be required before further state resources are committed to the Judiciary's computer upgrade. For a further discussion, see page A-28 in Volume 3.
3. The executive funds total maximum daily load expenditures with both one-time and on-going funds. However, the department has had significant issues with retaining qualified staff to complete the work. For a further discussion, see page C-53 in Volume 4.
4. The Gambling Control Division and Department of Corrections computer systems would replace systems plagued with development and/or implementation problems, and the legislature may wish to closely monitor activities in the 2007 biennium. For a further discussion, see pages D-22 and D-81 in Volume 4.
5. The helicopter purchase in DNRC is primarily to aid in fire suppression. A recent audit indicates that, while additional helicopters would aid in responding quickly to fires, the department is not able to use them to highest effectiveness because of a lack of pilots. Therefore, the legislature may wish to ask the department how the helicopters will be used and what efforts are underway to ensure that pilots will be available to fly them.
6. The legislature may wish to monitor and/or help articulate goals and measures of progress for the Shared Leadership project. For a further discussion, see page E-132 in Volume 4.
7. Two of the proposals for one-time expenditures to pay off recurring debt totaling \$23.0 million are classified as present law adjustments:
 - Paying off the IRIS debt
 - Full payment of the Crow Tribe settlement

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Present law is defined in statute as "...that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- 1) changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- 2) changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- 3) inflationary or deflationary adjustments; or
- 4) elimination of nonrecurring appropriations."

Because present law is used to determine what it costs to maintain on-going operations of state government, it is an important indicator of whether service reductions are likely if that level of funding is not maintained. Therefore, it is important that present law accurately reflect true costs of maintenance of state government operations. While the purpose of the appropriations for debt and settlement payout may be an on-going expenditure of government and not a new function or initiative, the proposal to pay all of the costs in one biennium is a new policy initiative. As a consequence, the totals used to determine the on-going costs of government are skewed by the addition of these proposals.

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes over \$118 million in general fund new initiatives (new proposals) in the 2007 biennium. Of the total, over \$40 million is in HB 2 and the remainder is in other bills, language, or transfers. The Governor also proposes \$6.3 million in revenue initiatives that bring the net general fund impact to \$112.0 million over the biennium. The following figure shows the major initiatives, by source of appropriations authority and in order of magnitude.

Figure 12 Major New Initiatives - Executive Budget 2007 Biennium (Millions)	
Agency/Initiative	Amount
Revenue Proposals	
Department of Revenue Loan Payback*	(6.0)
Department of Justice Pathologist	(0.3)
Total Revenue Proposals (revenue increase)	(6.3)
Expenditure Proposals	
Increased repair/maintenance (long-range building)	\$30.0
State employee pay plan	31.6
Protested property tax reserve	4.0
Replace cultural trust fund balance	3.9
Pay federal government for share of workers' compensation transfer to general fund	0.2
Pension funds actuarial soundness	7.2
Other Language Appropriations	1.4
Total Non-HB 2 Expenditure New Proposals	\$78.3
HB 2	
Various - Enhance/Complete Computer Systems**	\$9.9
OPI - Various Education Programs	5.5
University System - 2 Year Education Units Equipment	5.0
University System - Shared Leadership	4.9
Administration - Emergency Telecommunications	4.1
DPHHS - Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	2.2
Judiciary - "Unfit to Proceed" Costs	2.0
DPHHS - Nursing Home Bed Tax	1.9
DPHHS - CHIP Enrollment Increase	1.7
Labor and Industry - Employment Security Account Funding Switches***	1.2
DPHHS - Child Support Maintenance	0.8
DPHHS - Continuance of Diversion of Tobacco Tax	0.7
Administration - Public Safety Communications	0.6
OPI - Indian Education for All	0.5
Other Agencies, Net of Miscellaneous Reductions****	-1.0
Total HB 2 New Proposals	\$40.0
Total Expenditure New Proposals	\$118.3
Total New Proposals	\$112.0
*Savings as a result of \$16 million IRIS debt payoff	
**Includes only those enhancement requested in new proposals. As such, it excludes completion of POINTS, and the gambling control enhancement.	
***Reversal of fund switch enacted by the 2003 Legislature	
****Various costs savings in DPHHS total \$3.1 million. The Department of Justice statewide FTE reduction (\$0.46 million) is included in new proposals.	

Figure 13 shows the expenditure proposals, only, by functional area of government. As evidenced by the spending allocations, Governor Martz priorities are to:

- Provide a pay plan for state employees (page 80 of this volume)
- Provide maintenance on state buildings (Section F in Volume 4)

- Enhance, complete, or develop various computer systems for ongoing operations of several agencies (various agencies, Volumes 3 and 4)
- Provide enhanced funding to school districts for specific programs (beginning on page E-1 of Volume 4)
- Promote economic development in partnership with the Montana University System (beginning on page E-75 of Volume 4)
- Provide for emergency and public safety communications (beginning on page A-174 of Volume 3)
- Enhance services to clients of various human services programs and increase rates to certain providers (beginning on page B-1 of Volume 3)
- Maintain the actuarial soundness of the various pension plans (page 88 of this volume)

Figure 13
Expenditure New Initiatives by Functional Area - Executive Budget
2007 Biennium
(Millions)

Agency/Initiative	Amount	Percent of Total	Cumulative Percent
<u>Various Agencies/Not Agency Related</u>			
Executive Pay Plan	\$31.6	26.7%	
Increased Repair/Maintenance - Long Range Building	30.0	25.4%	
Enhance/Complete Computer Systems*	9.9	8.4%	
Pension Funds	7.2	6.1%	
Language Appropriations	1.4	1.2%	
Pay Federal Government for Workers' Comp	0.2	0.2%	
Subtotal Various Agencies	\$80.3	67.9%	67.9%
<u>Higher Education</u>			
2 Year Education Units Equipment	\$5.0		
Shared Leadership	4.9		
Subtotal Higher Education	\$9.9	8.4%	76.2%
<u>Human Services (DPHHS)</u>			
Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	\$2.2		
Nursing Home Bed Tax	1.9		
CHIP Enrollment Increase	1.7		
Child Support Maintenance	0.8		
Continuance of Diversion of Tobacco Tax	0.7		
Miscellaneous Other (Including Cost Savings)	-2.2		
Subtotal	\$5.2	4.4%	80.6%
<u>K-12 Education</u>			
Various Education Programs	\$5.5		
Indian Education for All	0.5		
Audiology	0.2		
Subtotal K-12 Education	\$6.1	5.2%	85.8%
<u>All Other Agencies</u>			
Administration - Emergency Telecommunications	\$4.1		
Administration - Public Safety Communications	0.6		
Arts Council - Replace Cultural Trust	3.9		
Revenue - Protested Property Tax Reserve	4.0		
Judiciary - "Unfit to Proceed" Costs	2.0		
Labor and Industry - Employment Security Account Funding Switches**	1.2		
Miscellaneous Other (Including Justice Statewide FTE Reduction)	1.0		
Subtotal All Other Agencies	\$16.8	14.2%	100.0%
Total All Initiatives*	\$118.3		

*The only Department of Corrections new proposal was for computer enhancement, included in the "Enhance/Complete Computer Systems" item.

The figure shows that the proposed pay plan and increased maintenance on state properties would be over half of the proposed new initiatives. If computer systems, human services and education increases were added, the total would increase to almost 80 percent.

A major new initiative not included on this list because the Governor classifies it as a present law adjustment is the proposal to payout all debt and settlement obligations for the integrated revenue information system (IRIS) and the Crow Tribe settlement, totaling \$23 million. It is the payoff of IRIS debt (\$16 million) that enables the \$6 million loan payback revenue enhancement, as early payoff of the debt eliminates the general fund obligation for debt service payments in the 2007 biennium.

FIXED COSTS

Several programs within state government provide services to other functions of state government, for which they charge a fee. The legislature budgets funds so that the agencies receiving services can meet the costs of those services. The legislature does not appropriate funds for the provider programs because they are utilizing internal service funds, which do not require appropriations.

In those cases, the legislature approves the rates charged by provider programs.

Figure 14 details each of the internal service programs and the total fixed costs included in the executive budget in support of funding those functions. The figure also compares total costs in the executive budget in the 2007 biennium with costs budgeted in the 2005 biennium.

Figure 14 Comparison of Fixed Costs 2005 to 2007 Biennium (in Millions)					
Subcommittee/Agency	Program	2005 Biennium	2007 Biennium	Difference	Percent
General Government					
Administration	Insurance and Bonds	\$30.223	\$28.932	(\$1.291)	-4.3%
	Warrant Writing Fees	1.733	1.584	(0.149)	-8.6%
	Payroll Service Fees	0.897	0.906	0.009	1.0%
	Data Network Services	19.455	21.585	2.130	10.9%
	SABHRS Operating	9.446	12.670	3.224	34.1%
	Messenger Services	0.268	0.324	0.056	21.0%
	Rent - Buildings	11.506	13.523	2.017	17.5%
Legislative Audit Division	Audit Fees	2.799	3.074	0.275	9.8%
Natural Resources and Commerce					
Fish, Wildlife, and Parks	Grounds Maintenance	0.638	0.669	0.031	4.9%
Various	Statewide Cost Allocation/State Fund Allocation	<u>2.209</u>	<u>3.673</u>	<u>1.464</u>	66.3%
Total		<u>\$79.174</u>	<u>\$86.942</u>	<u>\$7.768</u>	9.8%

As shown, fixed costs increase by over \$7.7 million in the 2007 biennium over the 2005 biennium appropriations. Costs for most charges show significant increases, with the allocation reduced in two functional areas. The following briefly discusses each area of significant increase.

- **SABHRS Operating** – SABHARS operating allocates the costs of the centralized Statewide Accounting, Budgeting, and Human Resources System to state agency budgets. During the 2005 biennium, SABHRS was billed based on a service level agreement outside of the allocation model comprised of most other computer applications. For the 2007 biennium, SABHRS was included in the cost allocation model. Inclusion of SABHRS in the cost allocation model shifted costs from other system applications to SABHRS. It is this methodology change that causes the SABHRS costs to increase.
- **Messenger Services** – Messenger services include all mail sorting, pickup, and delivery to state agencies. Cost increases are primarily because the legislature lowered these charges in the 2005 biennium to deplete a large fund balance. Costs in the 2007 biennium are comparable to the 2003 biennium.

- Rent – Rent consists of a per square foot charge to agencies for occupied office and warehouse space. Office space per square footage rental rates increase 10.4 percent in FY 2006 over the FY 2004 level and an additional 1.0 percent FY 2006. Warehouse rates increase about 73.0 percent. Increases are due to increases in utilities, maintenance, and contracted services (such as janitorial), as well as a change in the allocation of costs for warehouse space to include a greater number of facility costs.
- Statewide Cost Allocation/State Fund Cost Allocation – The Statewide Cost Allocation Plan (SWCAP) is combined by the executive in the 2007 biennium with the State Fund Cost Allocation Plan (SFCAP). SWCAP, which was not previously allocated as a fixed cost to agencies, is an indirect charge to ensure that non-general fund sources help support a variety of general fund functions that support all of state government. These funds are deposited to the general fund. SFCAP is a direct charge against non-general fund state sources to ensure that those sources also support centralized functions of state government. The increase is primarily due to addition of a fixed cost allocation for SWCAP to ensure appropriate payment by agencies.

Each of the fixed costs and related issues enumerated above are discussed in greater detail in the Department of Administration narrative in Volume 3, and in the Department of Fish, Wildlife, and Parks (capitol grounds maintenance) in Volume 4 of the Legislative Budget Analysis 2007 Biennium.

INFLATION/DEFLATION

Statute requires the governor to submit a present law budget, with "present law" defined as "that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature". The statutory definition includes inflationary and deflationary adjustments. The executive budget does not include a general inflation factor for all operating expenses, but instead applies an inflation or deflation factor to fiscal 2004 expenditures for only 10 specific items.

Figure 15 shows the executive budget inflation and deflation factors and the items to which they are applied. Of the 10 items, the 3 inflated items are purchased outside of state government. The deflated items or services are purchased from other state agencies, and payments for these items or services go into a proprietary account. The legislature sets the rates that other state agencies must pay for the items or services, and thus determines the fund levels maintained in proprietary accounts.

Although the executive is requesting inflationary increases for electricity and natural gas appropriations, it is also requesting that the legislature approve a Governor's Office language appropriation in HB 2 for \$1.7 million general fund and \$2.0 million state special and federal special funds. These amounts would become appropriated if the state's natural gas contract and electricity default supplier rates for the 2007 biennium exceed the rates paid in fiscal 2004 as inflated by the percentages listed in Figure 15. Please see the LFD comment in the Office of Budget and Program Planning narrative under the Governor's Office (Volume 3, Legislative Budget Analysis, 2007 Biennium, page A-64) for further details.

Figure 15
Inflation and Deflation Factors
Executive Budget 2007 Biennium

Account	Item Name	Percentage Change From Fiscal 2004 Base		Dollar Change					
		Fiscal 2006	Fiscal 2007	State Agencies		University System		Total	
				Fiscal 2006	Fiscal 2007	Fiscal 2006	Fiscal 2007	Fiscal 2006	Fiscal 2007
<u>Inflation</u>									
62601	Electricity	1.00%	2.00%	\$46,851	\$93,703	\$46,195	\$92,391	\$93,047	\$186,094
62603	Natural Gas	18.00%	12.00%	400,239	266,826	482,970	321,980	883,209	588,806
63125	Library Books	6.00%	9.00%	<u>21,439</u>	<u>32,158</u>	<u>220,055</u>	<u>330,083</u>	<u>241,494</u>	<u>362,241</u>
Subtotal				\$468,530	\$392,687	\$749,221	\$744,454	\$1,217,750	\$1,137,141
<u>Deflation</u>									
62142	Disk Storage Charges DofA	-10.00%	-10.00%	(\$102,873)	(\$102,873)	\$0	\$0	(\$102,873)	(\$102,873)
62172	Batch CPU Seconds DofA	-10.00%	-10.00%	(111,996)	(111,996)	(133)	(133)	(112,128)	(112,128)
62177	TSO CPU Seconds DofA	-10.00%	-10.00%	(22,964)	(22,964)	0	0	(22,964)	(22,964)
62178	IDMS CPU Seconds DofA	-10.00%	-10.00%	(214,067)	(214,067)	0	0	(214,067)	(214,067)
62180	CICS CPU Seconds DofA	-10.00%	-10.00%	(22,696)	(22,696)	0	0	(22,696)	(22,696)
62404	In-State State Motor Pool	-13.00%	-12.50%	(282,441)	(271,578)	(3,396)	(3,266)	(285,837)	(274,843)
62510	Motor Pool-Lease Vehclces	-13.00%	-12.50%	<u>(329,142)</u>	<u>(316,483)</u>	<u>0</u>	<u>0</u>	<u>(329,142)</u>	<u>(316,483)</u>
Subtotal				(\$1,086,178)	(\$1,062,655)	(\$3,529)	(\$3,398)	(\$1,089,707)	(\$1,066,054)
Net Change				<u>(\$617,648)</u>	<u>(\$669,968)</u>	<u>\$745,692</u>	<u>\$741,055</u>	<u>\$128,044</u>	<u>\$71,088</u>

LONG RANGE PLANNING

The Governor's request for Long-Range Planning (LRP) includes a total of \$197.2 million for grants, loans, capital projects, and environmental cleanup. The executive request is summarized in Figure 16.

The most significant funding request for LRP includes a total of \$161.2 million for projects included in the Long-Range Building Program (LRBP). The request is an increase of 102 percent from the projects approved in the 2005 session. In addition, a \$5.1 million bond issue is recommended for the construction of Montana Department of Transportation (DOT) equipment storage buildings statewide. The debt service on the proposed issue will be paid with DOT state special revenue. Consequently, no new general fund debt service payments will be incurred during the 2005 biennium through this program.

The executive budget includes two uses of "one-time" monies from the general fund for Long Range Planning programs. The first recommendation is a \$30 million transfer to the LRBP account. The funds will be used to make headway on the severe backlog of deferred maintenance in the state complex. The second transfer is \$3.9 million, and would replenish the Cultural Trust corpus for the state purchase of Virginia and Nevada Cities in 1997. Both general fund transfers are designed to save state funds in the future.

In funding a one-time-only additional \$30 million for LRBP projects, the executive addresses the need for deferred maintenance in state complex and provides potential cost savings for future biennia. Savings will occur because the future cost of projects will increase both as the buildings fall into greater disrepair and as the cost of materials and labor increase over time. While the backlog of deferred maintenance will remain critical, at an estimated cost of over \$100 million, the additional funds will slow the buildup of necessary deferred maintenance projects during the 2007 biennium. Consequently, the state will experience savings by funding the deferred maintenance now.

Figure 16		
Executive Budget Request Long-Range Planning 2007 Biennium		
Program / Project	Amount	Program Total
Long-Range Building Program		\$161,203,540
Projects Funded with Cash/Current Revenues	\$156,103,540	
Projects Funded with Bonded Debt	5,100,000	
State Building Energy Conservation Program		2,500,000
Treasure State Endowment Program		17,400,000
Grants	17,400,000	
Loans	-	
Resource Indemnity Trust Grant & Loan Programs		15,257,876
Renewable Resource Grants	3,967,847	
Renewable Resource Loans	7,236,264	
Reclamation & Development Grants	4,053,765	
	8,021,612	
Cultural & Aesthetic Grant Program		800,553
Grants	770,553	
Capital Artwork Care & Conservation	30,000	
Total Long Range Planning Recommendations		<u>\$197,161,969</u>

General fund appropriations will no longer be required in future biennia for support of the Cultural and Aesthetic (C&A) grant program. Because the 1997 Legislature removed half of the trust corpus for the purchase of Virginia and Nevada Cities, the C&A grant program has required general fund dollars to bolster its ability to fund cultural grants. With the Governor's recommendation, the program will again be self-supporting.

LRP grant funding will be greater in the 2007 biennium as a result of higher interest earnings in several LRP programs. The Treasure State Endowment grant program (TSEP) and the Resource Indemnity Trust grant and loan programs (RIT) contain grant recommendations that exceed the grant awards of the 2005 biennium. The TSEP grant recommendation exceeds grants awarded in the 2005 biennium by 5.1 percent. Grants from the RIT grant and loan program will recommend grants at a level of 25.3 percent greater than were appropriated in the 2005 biennium.

Section F, in Volume 4, includes detailed information regarding each of the programs related to Long-Range Planning.





EXECUTIVE BUDGET – OTHER LFD ISSUES

INTRODUCTION

This section contains LFD issues related to the executive budget as a whole. These issues are in addition to specific issues raised in the agency budget presentations. Each item is listed here and discussed in further detail in the following pages.

HIGHLIGHTS

Unresolved Policy Issues. There are other issues with potential material impacts on the 2007 biennium budget for which the fiscal impacts are either uncertain or unknown, and are not addressed in the executive budget. Most notable is the K-12 funding lawsuit.

Structural Balance. Structural balance refers to the matching of ongoing expenditures of government with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. The executive budget appears to be structurally balanced. However, the amount by which ongoing revenues exceed ongoing expenditures might be argued.

Expenditure Limitation. Section 17-8-106, MCA, provides for an expenditure limitation intended to control growth in state government spending. The executive budget exceeds the statutory limit for growth in the budget, meaning that the growth in the budget exceeds average Montana personal income growth.

Governor Martz Budget Revisions. The executive submitted minor amendments to the original executive budget on December 15, with a total general fund impact of \$1.9 million. Although not included in the LFD analysis, the items will be brought to the attention of the applicable appropriations subcommittee.

UNRESOLVED POLICY ISSUES

There are other issues with potential material impacts on the 2007 biennium budget for which the fiscal impacts are either uncertain or unknown, and are not addressed in the executive budget. Most notable is the K-12 funding lawsuit, discussed on page 119 of this volume. Other pending litigation issues are discussed on page 124 of this volume.

Six issues with potential major fiscal impacts that either currently cannot be estimated or are of unknown resolution are discussed in this section. The executive budget does not specifically address the issues due to their uncertainty, but the legislature should be aware that significant resources and/or policy changes could be required and these issues should be considered in legislative deliberations to balance the budget.

MEDICARE MODERNIZATION ACT

The federal Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) was signed into law in December 2003. The most significant change due to passage of the MMA is the addition of an outpatient prescription drug benefit (Part D) for Medicare beneficiaries, which is one of the most fundamental changes to Medicare in recent history. Despite state and federal implementation issues, outpatient drug assistance is a significant benefit for Medicare beneficiaries. To date, there are many undefined aspects of the MMA, including the underlying data needed to calculate the fiscal effects. At this point, it is not possible to tell whether Montana will experience a net gain or loss in general fund costs due to offsetting aspects of the MMA, and it is not evident how fiscal and policy issues associated with the MMA will be addressed in the executive legislative package. For a further discussion, see page 140 of this volume and page B-16 in Volume 3.

MAIDS LAWSUIT

In September 2002, the Montana Association for Independent Disability Services, Inc. (MAIDS) and several individuals with developmental disabilities filed suit. This suit alleges that the disparity in wages and benefits paid to employees of community based providers verses the wages and benefits paid to employees of state institutions has resulted in irreparable and unnecessary harm to the plaintiffs.

A finding in favor of the plaintiffs and requiring the state to reimburse contractors at a level that provides direct care wage rates that are comparable to state employees would likely have a financial impact on the developmental disabilities system that would be measured in terms of millions of dollars. The potential for similarly situated employee groups of contractors to file similar legal actions exists. The probability and magnitude of such action is currently unknown. Furthermore, how such a finding might impact the definition of employee/employer relationships and other aspects of labor relations and compensation has not been studied.

For a further discussion, see page B-31 of Volume 3.

FIRE COSTS

The state's share of fire suppression costs is funded with general fund. Traditionally, the legislature does not budget for fire costs due in part to the uncertainty of what those costs will be. Instead, the legislature provides a supplemental appropriation in the next legislative session to pay all state costs. The primary issues with this approach are whether the fund balance will be adequate to pay all costs, as well as whether the state has sufficient cash flow to pay all costs due until the legislature can act.

The state experienced a severe fire season in FY 2004. The costs of that fire season would normally have placed a severe strain on state resources that would likely have necessitated a special session to provide authority to pay immediately due bills and/or reduce other expenditures to pay fire costs. However, a one-time general-purpose grant from the federal government was used for all state costs. It is highly unlikely that this largesse from the federal government will be repeated. Given the continuing drought, the 2007 biennium fire seasons could also be severe, and absent some other mechanism, the ending fund balance would need to be sufficient to address those potential costs.

For a further discussion, see page C-129 in Volume 4.

PUBLIC DEFENDER

The Law and Justice Interim Committee voted to introduce legislation in the 2005 legislative session to provide a statewide public defender system, which could have a significant fiscal impact on the Judiciary. The system proposed would provide public defender services in criminal and certain civil cases for any individual who is: 1) determined to be financially unable to retain private counsel; and 2) accused of an offense that could result in the person's loss of life or liberty if the person is convicted. The proposed system would provide public defender services in the Supreme Court or in any district court, justice court, or city or municipal court in the state. The cities and counties would continue to contribute funding in recognition of the incorporation of non-state courts.

District court assumption has proved to be significantly more costly than originally envisioned, in large measure due to higher than anticipated public defender costs. Increases in the number or severity of cases could have a significant impact on costs. In addition, the mechanisms in place to determine appropriate costs of services, and to ensure that the state is not subsidizing the local courts, will also be critical in future cost determinations.

For a further discussion, see page A-29 in Volume 3.

SB 424 – IMPACT AID ISSUE

Beginning in FY 2005, SB 424 requires school districts to pay employee retirement costs out of the fund from which the employees' wages are funded. In September 2003, a coalition of impact aid school districts petitioned the US Department of Education for a hearing regarding whether SB 424 violated federal law. The federal law in question says that a state may not make less state aid available to school districts as a result of the district's impact aid status. The Department of Education held a hearing in Helena in March 2004, and ruled against the state in June. The plaintiffs filed a petition in June 2004 for declaratory judgment and injunctive relief and also sought a preliminary injunction to halt implementation of SB 424. The case was dismissed in district court. Subsequently, the plaintiffs appealed to the Supreme Court, which granted the preliminary injunction in August 2004, but then reversed itself in September 2004. The case remains in the Supreme Court and it may rule on the case in 2005.

Should the state lose this case the cost to the general fund in guaranteed tax base aid for retirement costs will be approximately \$1.0 million per year.

NATIONAL ANTI-TERRORISM BILL

The national anti-terrorism bill was signed into law on December 17, 2004. A component of this law is the requirement that each state have similar drivers' licenses to make it harder to produce and obtain fake licenses. The Montana Department of Motor Vehicles (DMV) believes that Montana's drivers license already meets the basic requirements of this standard license, but that some changes may need to be made to Montana's birth certificates, which are used as a primary document to prove identity by the state. DMV does not have an analysis of the costs associated with any changes required pending rule creation and promulgation by the federal government.

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of ongoing expenditures with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. If expenditures exceed revenues, then structural *imbalance* occurs. General fund expenditures exceeded ongoing revenues for 12 of the past 22 years (see Figure 1). In the mid- to late-1990's, the legislature made significant progress, reaching a sizable positive balance in FY 2000. It should be noted that during this time, Montana as well as other states were reaping the benefits of an information technology boom and the significant increase in capital gains tax collections. However, the pendulum shifted the other way beginning in FY 2001, where revenues were slightly above expenditures. The unprecedented revenue shortfall in the 2003 biennium intensified the imbalance heading into the 2005 biennium. Historically, legislators have faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in corrections costs, increased human services demands, and pressures for increased education funding. In the 2005 session, legislators will enjoy what appears to be a structurally balanced executive spending proposal, although there is some question as to whether some of the projected revenues are truly ongoing.

Figure 1

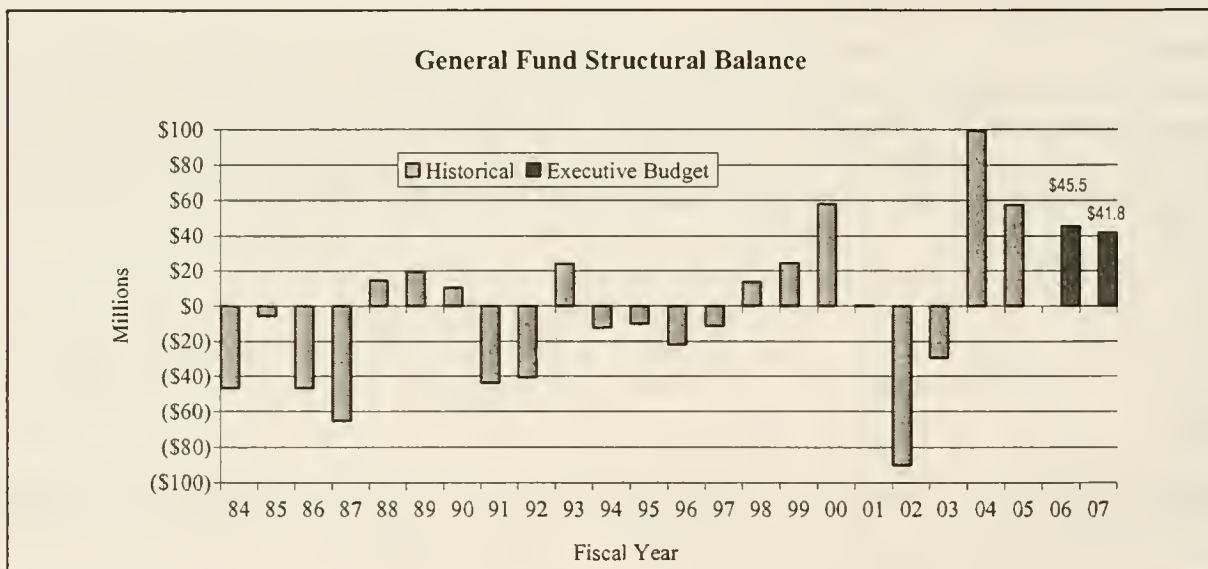


Figure 2 shows that the anticipated revenues, using revenue estimates in HJR 2, exceed ongoing expenditures proposed in the executive budget for the 2007 biennium by \$87.3 million. However, one might argue that a portion of oil and gas taxes should not be considered ongoing revenue, as this revenue source is likely to go through a period of correction that will result in a lower level of ongoing revenues. Inclusion of one-time sources of revenue results in a misleading estimation of structural balance. Since the executive budget uses the total revenue estimate in its determination of structural balance, it may be necessary to make some adjustments. The following narrative establishes the adjustment necessary for one-time revenues and expenditures to arrive at a comparison of ongoing revenues to ongoing expenditures.

Figure 2

Revenue and Disbursement History General Fund & School Equalization Accounts In Millions										
Fiscal Year	General Fund		Surplus /	School Equalization		Surplus /	GF/SEA	GF/SEA	Surplus /	Biennium
	Revenue	Disburse.	Deficit	Revenue	Disburse.	Deficit	Revenue	Disburse.	Deficit	Surplus/Deficit
A 84	\$330.305	\$357.387	(\$27.082)	\$242.384	\$261.753	(\$19.369)	\$572.689	\$619.140	(\$46.451)	
A 85	364.522	380.359	(15.837)	281.275	271.016	10.259	645.797	651.375	(5.578)	(\$52.029)
A 86	349.541	366.815	(17.274)	252.899	282.166	(29.267)	602.440	648.981	(46.541)	
A 87	346.690	391.325	(44.635)	263.052	283.428	(20.376)	609.742	674.753	(65.011)	(111.552)
A 88	391.152	370.853	20.299	276.216 *	281.886	(5.670)	667.368	652.739	14.629	
A 89	411.729	388.270	23.459	275.589 *	279.536	(3.947)	687.318	667.806	19.512	34.141
A 90	447.962	432.323	15.639	282.389	287.393	(5.004)	730.351	719.716	10.635	
A 91	420.257	457.612	(37.355)	385.031	391.500	(6.469)	805.288	849.112	(43.824)	(33.189)
A 92	487.036	523.072	(36.036)	393.591 *	398.059	(4.468)	880.627	921.131	(40.504)	
A 93	539.955	523.553	16.402	412.903	405.067	7.836	952.858	928.620	24.238	(16.265)
A 94	480.021	497.921	(17.900)	411.834	406.388	5.446	891.855	904.309	(12.454)	
A 95	646.149	535.461	110.688	289.199 *	409.822	(120.623)	935.348	945.283	(9.935)	(22.389)
A 96	963.193	984.997	(21.804)				963.193	984.997	(21.804)	
A 97	986.570	997.835	(11.265)				986.570	997.835	(11.265)	(33.069)
A 98	1,034.382	1,020.591	13.791				1,034.382	1,020.591	13.791	
A 99	1,068.111	1,043.418	24.693				1,068.111	1,043.418	24.693	38.484
A 00	1,163.641	1,105.598	58.043				1,163.641	1,105.598	58.043	
A 01	1,269.472	1,268.938	0.534				1,269.472	1,268.938	0.534	58.577
A 02	1,265.713	1,355.903	(90.190)				1,265.713	1,355.903	(90.190)	
A 03	1,246.381	1,275.827	(29.446)				1,246.381	1,275.827	(29.446)	(119.636)
A 04	1,381.565	1,282.038	99.527				1,381.565	1,282.038	99.527	
F 05	1,384.639	1,327.162	57.477				1,384.639	1,327.162	57.477	37.368
F 06	1,432.075	1,386.600	45.475	Executive Budget **			1,432.075	1,386.600	45.475	
F 07	1,472.515	1,430.690	41.825	Executive Budget **			1,472.515	1,430.690	41.825	87.300

* Excludes Education Trust & General Fund Transfers.
 ** Excludes Executive One-Time Proposals
 Note: The 1995 Legislature de-carried school equalization revenue to the general fund.

One-time revenues

The prices for oil and gas reached record levels in the past several months and have since declined. It is not known where the prices might level off, but it is expected to be at a level well below the record highs. For purposes of determining structural balance, an assessment of where oil and gas prices will level off is key. This is discussed in the section titled "Long-Term Stability of General Fund" on page 142 of this volume. If it is assumed that the amount of \$80 million of oil revenues is not ongoing revenue, then the positive structural balance of the executive budget is substantially reduced (see Figure 3) below. Although this is probably a worst-case scenario, it demonstrates the concern regarding the stability or instability of the general fund.

One-time expenditures

The executive budget balance sheet designates certain expenditures as one-time. Therefore, there is no need to adjust the projected structural balance estimate for one-time expenditures. It is possible, however, that the legislature may budget for some services on a one-time only basis. If this occurs, such expenditures can be used to offset the negative implications of one-time revenue.

Expenditure proposals

There are three other ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- Expanded expenditure growth, such as is represented in the proposed budget (approximately 10 percent biennial growth), can adversely impact structural balance. The school funding issue may result in even further expansion of expenditures.
- Realization of delayed implementation of expenditures. Annualization of the 2007 biennium pay plan, as proposed by the executive, will require an additional \$48.8 million general fund in the 2009 biennium.
- Growth in services rising from expansions in such programs as Medicaid or from increases in prisoner populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be ongoing revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth.

Achieving structural balance is a significant policy issue that the Fifty-ninth Legislature will need to address. If successful, in the 2007 biennium the legislature will make the budget process less problematic for both the executive and legislative branches in subsequent biennia.

LFD ISSUE	Based on the submitted balance sheet, the executive budget proposal for the 2007 biennium shows revenues are \$50.3 million greater than disbursements. The executive calculation does not consider any portion of the estimated revenues as being one-time. Figure 3 shows the structural balance for the 2007 biennium, comparing executive and legislative numbers. The structural balance in fiscal 2007 is \$50.3 million using executive numbers, and \$87.3 million using Revenue and Transportation Interim Committee estimates. The third column removes a portion of oil revenues to demonstrate the notion that oil revenues may return to earlier trends and should arguably not be considered ongoing revenues. Even then, the executive budget is structurally balanced.	Figure 3 Structural Balance 2007 Biennium (Millions)		
		Executive Budget	Using RTIC Estimate	Removes Portion of Oil Revenues
	Item			
	Anticipated Revenue	\$2,867.6	\$2,904.6	\$2,904.6
	One-Time Revenue	0.0	0.0	(80.0)
	Ongoing Revenue	2,867.6	2,904.6	2,824.6
	Ongoing Expenditures	2,817.3	2,817.3	2,817.3
	Structural Balance	\$50.3	\$87.3	\$7.3

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the executive budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance and safety related costs. This fund is in a chronic state of structural imbalance due to an inelastic revenue source and inflationary construction costs. In other parts of the executive budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed ongoing revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Legislative Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated ongoing revenues.

EXPENDITURE LIMITATION

2007 BIENNIUM EXECUTIVE BUDGET EXCEEDS STATUTORY LIMIT

Section 17-8-106, MCA, limits the increase in biennial appropriations ("state expenditures") from the general fund, state special revenues, and the cash portion of the capital projects fund to the growth in Montana's personal income. With two exceptions, appropriations for the 2007 biennium cannot exceed appropriations for the 2005 biennium increased by the growth in Montana personal income. Section 17-8-106, MCA, states:

Expenditure limitation -- exception. (1) Except as provided in subsection (2), the state expenditures for a biennium may not exceed the state expenditures for the preceding biennium plus the product of the state expenditures for the preceding biennium and the growth percentage. The growth percentage is the percentage difference between the average Montana total personal income for the 3 calendar years immediately preceding the next biennium and the average Montana total personal income for the 3 calendar years immediately preceding the current biennium.

(2) The legislature may appropriate funds in excess of this limit from the reserve account if:

- (a) the governor declares that an emergency exists; and
- (b) two-thirds of the members of each house approve a bill stating the amount to be spent in excess of the expenditures limitation established in subsection (1), the source of the excess revenue to be spent, and an intention to exceed the limitation.

(3) Expenditures may exceed the expenditures limitation only for the year or years for which an emergency has been declared.

(4) The legislature is not required to appropriate the full amount allowed in any year under subsection (1).

The proposed executive budget for the 2007 biennium exceeds the statutory expenditure limit by \$12.6 million. Under the executive recommendation, the increase in spending in applicable categories that are affected by the limitation will be greater than the growth in Montana's personal income between 2000-2002 and 2002-2004.

The following is a summary of the expenditure limitation calculations applied to the executive budget for the 2007 biennium.

CALCULATION OF LIMIT

The following types of appropriations are excluded from the calculations:

- Money received from the federal government
- Payments on bonded indebtedness
- Money paid for unemployment or disability benefits
- Money received from the sale of goods and services
- Money paid from permanent endowments, constitutional trusts, or pension funds
- Proceeds from gifts and bequests
- Money appropriated for tax relief
- Funds transferred within state government or used to purchase goods for resale

Four steps are required to determine the expenditure limit:

Step 1 - Determine the base appropriation level for the 2005 biennium

Step 2 - Determine the executive request for the 2007 biennium by summing appropriations for the general fund, state special revenue, and the cash portion of the capital projects fund. Exclude any of the items listed above.

Step 3 - Determine the growth in average personal income for the three years preceding the current biennium (2000, 2001, and 2002) and the three years preceding the next biennium (2002, 2003, and 2004). The growth in Montana's personal income between these two periods is 8.53 percent.

Step 4 - Increase the 2005 biennium base appropriations by the growth in personal income to establish the expenditure limitation. Subtract the executive budget appropriations for the 2007 biennium from the 2005 base limitation. This difference is a negative \$12.6 million.

Compliance

Figure 4 shows the calculations used to determine the spending limitation for the 2007 biennium. The calculations show that the executive budget recommendations for the 2007 biennium exceed the expenditure limit by \$12.6 million. To comply with statute in setting the 2007 biennium budget, the legislature has the following options:

- Reduce total requested appropriations from the general fund, state special revenue fund, and/or the cash long-range building program by \$12.6 million below the executive level.
- As allowed in 17-8-106(2), MCA, if legislation is passed by 2/3 of the members of each house, the limit may be exceeded. The legislation must: 1) state the amount of excess to be spent; 2) the source of the excess revenue to be spent; and 3) an intention to exceed the limitation.
- Repeal 17-8-106, MCA, effective FY 2005

LFD ISSUE

The proposed executive budget for the 2007 biennium exceeds the statutory expenditure limit by \$12.6 million. Regardless of the executive budget proposal, if the legislature increases school funding above the amounts in the executive budget without any corresponding reductions in other areas and/or utilizes more of the one-time revenue to fund one-time expenditures, the expenditure limit will be exceeded. This will require the 59th Legislature to choose from the options listed above.

Figure 4
Expenditure Limitation Calculation
2007 Biennium

<u>Step 1</u>	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>	<u>Biennium</u>
Base Appropriations			
State Expenditures*	\$2,108,265,004	\$1,934,720,981	\$4,042,985,984
Exclusions			
Debt service	(19,754,000)	(19,430,000)	(39,184,000)
Unemployment benefits	(582,718)	(582,718)	(1,165,436)
Proceeds of gifts or bequests**	0	0	0
Tax relief	0	0	0
Transfers	0	0	0
Total Exclusions	(\$20,336,718)	(\$20,012,718)	(\$40,349,436)
Base Appropriations	<u>\$2,087,928,286</u>	<u>\$1,914,708,263</u>	<u>\$4,002,636,548</u>
<u>Step 2</u>	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>	<u>Biennium</u>
Executive Budget			
State Expenditures*	\$2,287,660,463	\$2,107,127,357	\$4,394,787,820
Exclusions			
Debt service	(18,394,667)	(18,523,764)	(36,918,431)
Unemployment benefits	(522,975)	(522,975)	(1,045,950)
Proceeds of gifts or bequests**	0	0	0
Tax relief	0	0	0
Transfers	0	0	0
Total Exclusions	(\$18,917,642)	(\$19,046,739)	(\$37,964,381)
Executive Appropriations	<u>\$2,268,742,821</u>	<u>\$2,088,080,618</u>	<u>\$4,356,823,439</u>
<u>Step 3</u>	<u>Income</u>	<u>3-year Average</u>	<u>Growth %</u>
Personal Income Growth			
Calendar Year 2000	20,716,220,000		
Calendar Year 2001	22,281,006,000		
Calendar Year 2002	22,526,118,000	21,841,114,667	
Calendar Year 2003	23,651,446,000		
Calendar Year 2004 est.	24,937,723,000	23,705,095,667	8.53%
<u>Step 4</u>			
Expenditure Limitation			
Base Appropriations plus 8.53%		\$4,344,232,597	
Executive Budget		<u>4,356,823,439</u>	
Expenditure Balance		(\$12,590,841)	

* Appropriations of general fund, state special, cash capital projects

** The state accounting system does not track appropriations of donated revenue.

LFD ISSUE

The method differs with the method used to calculate budget comparisons required under 17-7-151, MCA, thus resulting in possible confusion by comparing different parts of the executive budget with different bases. The legislature may want to consider the value of the expenditure limitation and eliminate the requirement if it is found to be of little or no value.

GOVERNOR MARTZ BUDGET REVISIONS

Governor Martz submitted minor amendments to the original executive budget on December 15, with a total general fund impact of \$1.9 million. Due to timing, these amendments are not included in the LFD analysis, but are part of the official executive budget, and staff will bring them to the attention of the appropriations subcommittees as they act on agency budgets. Figure 5 summarizes the additions to the executive budget.

Figure 5
Governor Martz Budget Adjustments - December 15, 2004
2007 Biennium

Agency	General Fund		Other Funds		Comments
	FY 2006	FY 2007	FY 2006	FY 2007	
<u>HB 2</u>					
Governor's Office	---	---	(\$94,009)	(\$93,966)	Eliminate the Mental Health Ombudsman
DEQ*	2,000,000	---	---	---	Superfund related remedial studies
Corrections	---	---	-360,000	-360,000	Inmate Welfare Funds
Military Affairs	250,000	250,000			National Guard scholarship program
Public Health and Human Services	---	---	<u>3,339,016</u>	<u>4,032,460</u>	Adjust TANF caseload, benefits level
 Total HB 2	 \$2,250,000	 \$250,000	 \$2,885,007	 \$3,578,494	
<u>Statutory Appropriations</u>					
Adjust various statutory appropriations**	(\$1,200,000)				Reduce bond costs and certain payments
<u>Revenue Adjustments</u>					
Reduce institutional reimbursements	\$300,000	\$300,000	---	---	Reduce general fund revenue
<u>Other</u>					
Fish, Wildlife, and Parks	---	---	---	---	Change present law to new proposal
Public Health and Human Services	---	---	---	---	Change fund source in CHIP
Public Health and Human Services	---	---	---	---	Remove unnecessary TANF language
 Total 2007 Biennium Increased Costs (Reduced Revenue)	 \$1,350,000	 \$550,000	 \$2,885,007	 \$3,578,494	

*Biennial

**Over a three year period

Governor's Office - The executive budget funded the Mental Health Ombudsman, a position created by the legislature in response to consumer complaints during the establishment of mental health managed care, with federal Medicaid funds. According to the executive, the Centers for Medicare and Medicaid Services has determined the funds cannot be used for this purpose, and the executive proposes eliminating the Mental Health Ombudsman. The reduction includes 1.50 FTE.

Environmental Quality - This adjustment would add general fund for a superfund-related remedial investigation and feasibility study of three sites in the Kalispell area: 1) Kalispell Pole and Timber; 2) Reliance Refinery; and 3) Yale Oil Kalispell facilities.

Corrections - The executive included a HB 2 appropriation for a statutory appropriation, and withdraws the error.

Military Affairs – The executive funds the National Guard Scholarship program in the 2007 biennium. The program was funded for the 2005 biennium only at \$250,000 over the biennium.

Public Health and Human Services – The executive increases the temporary assistance for needy families (TANF) caseload estimate, and increases the monthly benefit by \$30.

Statutory Appropriations – The executive reduces statutory appropriation estimates for bond payments in FY 2005, and the cost of state contributions to local government law enforcement and fire personnel retirement costs for FY 2005, FY 2006, and FY 2007. Precise budget detail was not provided.

Revenue Reduction – The state institutions receive reimbursements from the federal government for Medicaid eligible residents. The executive has lowered the anticipated revenue to the general fund from these reimbursements.

Fish Wildlife and Parks – This change merely converts a present law adjustment to a new proposal for a decision package to restore non-game wildlife funds.

Public Health and Human Services – The first adjustment under “other” in Figure 5, changes the fund code for certain expenditures associated with specialty clinics. The second eliminates language no longer necessary.

OTHER FISCAL ISSUES TO CONSIDER

LFD Perspective





OTHER FISCAL ISSUES

INTRODUCTION

This section discusses several fiscal issues not directly related to the executive budget, but that will potentially have an impact on the budget passed by the legislature and/or the budget process. The purpose of this section is to provide legislators with an overview of each of these issues. The issues discussed in this section are listed below and are discussed in more detail in the pages that follow.

- **K-12 Lawsuit Issue.** The April 2004 district court decision that the school funding methodology is unconstitutional and that state funding is inadequate was upheld in November 2004 by the Supreme Court. The state is directed by the court to find a solution by October 2005.
- **Other Litigation Issues.**
 - *Human Services.* Two lawsuits allege deficiencies in services provided to the developmentally disabled. One is still in the courts. For the other, a court ordered settlement was signed in February 2004.
 - *Highway Patrol Class Action Lawsuit.* A lawsuit by 323 officers seeks overtime pay for all lunch hours for a period of 3½ years, and to have overtime and retirement contributions and benefits recalculated. A second lawsuit regarding wage claims was filed by 16 officers. A settlement agreement has been signed for both cases.
 - *PPL Protested Taxes.* Legislation is proposed that transfers half of property taxes, paid in protest and deposited in the general fund, to a separate account to be available for refund if necessary.
- **Tobacco Settlement Funds.** The state expects to receive \$42.1 million in the 2007 biennium, at least 40 percent of which will be deposited into a trust. Another 49 percent was earmarked for specific purposes. The general fund receives 11 percent.
- **I-149: Cigarette and Tobacco Tax Increases.** Initiative 149, passed by the voters in November 2004, is estimated to increase tax revenues by nearly \$40 million each year of the 2007 biennium.
- **Jobs and Growth.** The Jobs and Growth Tax Relief Act of 2003, legislation passed by Congress to provide fiscal assistance to the states, consisted of two types of fiscal relief: 1) a temporary increase in the federal Medicaid benefits participation rate; and 2) a grant of \$50 million.
- **Public Defender Study.** There is legislation being proposed to create a statewide public defender system.
- **District Court Assumption.** The executive budget request includes a supplemental for FY 2005. In addition, the Judiciary is seeking additional funding for the 2007 biennium.
- **Medicare Modernization Act.** Despite state and federal implementation issues, outpatient drug assistance is a significant benefit for Medicare beneficiaries.

- **Long-Term Stability of General Fund.** Since the general fund is critical to the operations of state government, the long-term stability of this account is an issue that must be examined for development of sound fiscal policies.
- **Statutory Appropriations.** Expenditures from statutory appropriations in the 2007 biennium are estimated at \$268.7 million, of which \$170 million is for entitlement payments to local government.
- **General Fund Transfers.** Transfers from the general fund to other funds in the 2007 biennium are \$41.2 million. A 30 percent increase in these transfers over the 2005 biennium is due primarily to an increase in U.S. mineral royalties, part of which is transferred to a special revenue account for distribution to eligible counties.
- **Fund Balance Adequacy/Reserves.** With the experiences of the current biennium still fresh, the legislature will need to determine what amount of ending fund balance is sufficient to ensure budget stability, particularly with the uncertainties of Montana's revenue stream and the overall economic outlook.
- **Other Major Funds.**
 - *Highway Special Revenue Account.* The 2005 Legislature is faced with a declining working capital balance in the highways state special revenue account
 - *Resource Indemnity Account.* Of seven accounts that have historically received portions of RIT allocations or interest earnings, two are projected to have negative balances by the end of the 2007 biennium

K-12 LAWSUIT ISSUE

INTRODUCTION

In October 2003, a coalition of 11 school districts, 4 organizations of school boards, teachers and administrators, and 7 parents filed suit against the state of Montana alleging that the state has failed to provide sufficient and equitable funding to school districts, and therefore the school funding system is unconstitutional. The plaintiffs alleged that the current funding system violates both Section 2 and Section 3 of Article X of the Montana Constitution. These sections state:

(2) The state recognizes the distinct and unique cultural heritage of the American Indians and is committed in its educational goals to the preservation of their cultural integrity.

(3) The legislature shall provide a basic system of free quality public elementary and secondary schools. The legislature may provide such other educational institutions, public libraries, and educational programs as it deems desirable. It shall fund and distribute in an equitable manner to the school districts the state's share of the cost of the basic elementary and secondary school system.

The case, *Columbia Falls v Montana*, was heard in January 2004 in Helena and on April 15th Judge Sherlock delivered his opinion. The Sherlock decision found the state's share of school district spending inadequate, and found that Montana's funding formula is not reasonably related to the costs of providing a basic system of free quality public elementary and secondary schools. The case was appealed to the Montana Supreme Court in June 2004. In November 2004, the Montana Supreme Court affirmed the Sherlock opinion.

BACKGROUND INFORMATION

THE LAWSUIT - COLUMBIA FALLS V. STATE OF MONTANA

Plaintiffs Argument

During District Court hearings under Judge Jeffery Sherlock in early 2004, the plaintiffs argued that the state's system of funding schools in Montana was inadequate and distributed inequitably. The plaintiffs asked, that the court provide declaratory and injunctive relief, compelling the State of Montana to:

1. Study and determine the components of free quality public elementary and secondary education;
2. Study and determine the costs of delivering that quality education to all students in Montana, including costs that vary based on student or district characteristics;
3. Implement a funding system that is based on educationally relevant factors and tailored to meet the costs of delivering a quality education;
4. Fully fund, and equitably distribute, the State's share of the cost of the public elementary and secondary school system;
5. Include a cost adjustment factor in the funding system; and
6. Establish a mechanism for periodic monitoring of and adjustment to the funding system to assure it reflects current costs of delivering quality education, and to prevent a recurrence of the historical trends of declining state support and failure to keep pace with increasing costs³.

³ Complaint in *Columbia Falls v. State of Montana*, Molloy and Gallik, October 9, 2003, pg 15.

Court Findings

Judge Sherlock delivered his opinion on April 15th, 2004. The Sherlock opinion contained 199 findings of fact and several conclusions of law. Two of the most important follow:

Finding 160. In sum evidence of the state's failure to adequately fund its share of the elementary and secondary school system in Montana is evidenced by the following:

1. The growing number of school districts budgeting at or near their maximum budget authority;
2. The increasing number of schools with accreditation problems;
3. The difficulty in attracting and retaining teachers, which is based to a large degree, on the decreasing salaries and benefits that are offered to Montana teachers compared to their counterparts in the United States;
4. The large number of programs that have been cut in recent years as evidenced by the testimony of numerous superintendents;
5. The increasing difficulties that schools are having constructing safe and adequate buildings or maintaining the code compliance of the buildings that currently exist;
6. The increasing competition for general fund dollars between special education and regular education, which lowers the available money to students in regular education programs;
7. The results of an Augenblick and Myers Study;
8. The testimony of various superintendents that, if they were forced to provide their educational programs at the BASE general fund amount, they could not meet accreditation standards or offer a quality educational program;
9. The declining share of the State's contribution to the general fund budget of Montana's school districts;
10. The fact that Montana's funding formula is not reasonably related to the costs of providing a basic system of quality public elementary and secondary schools. Further, it is clear that the current funding system was not based on a study of the funding necessary to meet what the state and federal governments expect of Montana's schools;
11. The fact that the Montana Supreme Court has stated that it is the State's obligation to adequately fund its share of the school financing formula (Helena Elementary I, 236 Mont. at 55, 769 P.2d at 690);
12. The fact that the Montana Supreme Court noted that "[i]n 1972, when our Constitutional Convention met, approximately 65% of General Fund revenues were funded through the Foundation Program."

Finding 195. In this finding, the Sherlock opinion states:

"195. A particular requirement is that the funding system must be based on educationally-relevant factors. This requires that the funding system be based on the costs of meeting the standards that govern the operation of Montana's schools. Once adequate levels of funding are determined, the State must then fund its share of the cost of the system. The State's share must be an amount that is adequate at the BASE or foundation levels to allow districts to meet the standards. As previously established, this applies not only to general funds, but to the overall costs of the elementary and

secondary system. In accomplishing this, it would be appropriate for the State to include a reasonable phase-in plan for implementing a new funding system⁴.”

The court rejected the plaintiff’s contention that the system was inequitably funded.

Court Conclusions

In the Conclusions of Law and Order, Sherlock wrote:

“7. ...there is no question that the current funding system is not reasonable, since the overwhelming evidence supports Plaintiffs’ contention that the funding system and the classifications contained therein are not based on educationally-relevant factors.

8. This Court hereby rules that the current state funding system violates Article X, Section 1(2) of the Montana Constitution in that the State has failed to recognize the distinct and unique cultural heritage of American Indians and has shown no commitment in its educational goals to the preservation of their cultural identity.

9. This Court hereby rules that the current Montana school funding system violates Article X, Section 1 of the Montana Constitution in that it fails to provide adequate funding for Montana’s public schools.

10. This Court further rules that the State of Montana has violated Article X, Section 1 of the Montana Constitution in that the State is not paying its share of the cost of the basic elementary and secondary school system.

11. With respect to Montana’s accreditation standards, this Court concludes that certain Conclusions of Law found by the Montana Supreme Court in Helena Elementary I remain accurate to this day. “Thus, the Montana School Accreditation Standards do not fully define either the constitutional rights of students or the constitutional responsibilities of the State of Montana for funding its public elementary and secondary schools.” 236 Mont. at 52, 769 P.2d at 692.

12. This Court takes into account the fact that some of the damage that the educators testified to at trial is prospective in nature. However, this evidence is persuasive and relevant. Just as the Montana Supreme Court did not feel it necessary to wait for “dead fish [to] float on the surface of our state’s rivers and streams before its farsighted environmental protections can be invoked” (MEIC, 77), this Court finds that it should not have to wait until Montana’s school system collapses in financial ruin prior to entering an order in this case.

13. To satisfy the Montana Constitution, the State’s school finance system must be based upon determination of the needs and costs of the public school system, and the school finance system must be designed and based upon educationally-relevant factors⁵”.

State Appeal

In June, the State appealed the decision to the Supreme Court. On August 9, 2004, the State presented its brief in the case to the Supreme Court. The brief argued that the claims of the plaintiffs in *Columbia Falls v. Montana* present non-justiciable political questions, and that the district court erroneously declared Montana’s school funding system unconstitutional beyond a reasonable doubt

⁴ Findings and Fact, Conclusion of Law and Order, Judge Sherlock, First Judicial District Court, in *Columbia Falls v. State of Montana*, April 15th, 2004.

⁵ *IBID*, pgs 50-51.

when it ignored or failed to distinguish countervailing evidence⁶. On August 30, 2004, the plaintiffs' reply disputed the political question and asserted that the district court correctly rejected the State's factual defenses. In addition, the reply contained a cross-appeal brief in which the plaintiffs argued that the Sherlock decision on the equity question was erroneously decided (does the current system violate equal protection guarantees). The plaintiffs' reply also requested that the effective date by which a new funding scheme be in place be advanced from October 1, 2005 (as in the Sherlock Decision) to May 1, 2005, in time to provide relief to the school system for the 2005-06 school year⁷.

Supreme Court Decision

In November 2004, the Supreme Court issued an abbreviated decision unanimously affirming the primary tenets of the Sherlock decision. The Court concluded that the question of adequate school funding is a justiciable question. The Court said "we affirm the District Court's conclusion that the current system, which has evolved without the benefit of any definition of what constitutes "quality", fails to adequately fund Montana's public schools. We do not, however, necessarily affirm everything that is said in the District Court's opinion..."

The court also affirmed the District Court conclusion that the state has failed to recognize the distinct and unique cultural heritage of American Indians and has shown no commitment in its education goals to the preservation of Indian cultural identity.

Finally, the court affirmed the District Court's selection of October 1, 2005 as the effective date of its order.

The Supreme Court will publish its final in-depth conclusions sometime after January 1, 2005.

RECOMMENDATIONS

The conclusion of the District Court and the Supreme Court is that until such time as the legislature assesses education needs and defines "quality", it is not in a position to construct a funding system rationally related to educationally relevant factors.

As a result, staff recommends the legislature do the following:

- Define the educationally relevant elements of a basic system of free quality public elementary and secondary schools
- Determine the costs of delivering the resources required by that system for both operating and capital expenses
- Devise a funding formula in law that will determine the state's share of school districts' resources
- Determine what state and district revenues will be required to pay for the system
- Devise a periodic review process of the system to insure it meets future educational needs

If the legislature follows these recommendations, it should involve the Board of Public Education

⁶ Brief of Appellant to the Montana Supreme Court in *Columbia Falls v. State of Montana, McGrath and Morris*, August 9, 2004.

⁷ Respondents Answer and Cross Appeal Brief to the Montana Supreme Court, in *Columbia Falls v. State of Montana, Molloy and Gallik*, August 30, 2004.

because of its general supervision of the public school system and in crafting the accreditation standards and teacher licensure rules. A major issue will be who sets the standards, the legislature or the Board.

A 1992 district court decision found that the Board of Public Education is vested with constitutional rule-making authority. This ruling was never appealed to the Supreme Court. The chief counsel to the legislature has stated that this ruling is challengeable by the legislature because the Constitution gives the legislature sole powers to appropriate money from the treasury, and if the Board may promulgate standards for which the state must appropriate more money, then the powers of each body is in conflict.

Other constitutional entities that need to be involved in the school funding remedy will be local school boards. Article X, Section 8 of the Montana Constitution states: "The supervision and control of schools in each school district shall be vested in a board of trustees to be elected as provided by law." The association of Montana school boards was a plaintiff in the Columbia Falls suit. The remedy crafted by the legislature will need to be cognitive of the local control of schools guaranteed in the Constitution.

In developing a remedy, the legislature may want to consider to what extent a costing study would be helpful. There are many kinds of studies to choose from and many firms that provide services in this capacity. Caution is encouraged in selecting a cost study, as it is a highly subjective process, and past results in other states have revealed a checkered history. The cost of using nationally recognized firms to conduct a study may be between \$200,000 and \$500,000. Many of these studies have been done in other states. The duration of most studies is usually six months.

If a study is completed, a funding formula that determines the state share and the local share of education funding will also have to be crafted. This may involve the creation of new entitlement factors for which no data is currently collected. If this is the case, the Office of Public Instruction may be required to accomplish new tasks that may require additional funding.

If a study is not desired, the legislature may want to consider the recommendations of the Montana K-12 Renewal Commission. The Renewal Commission was established by HB 736 in the 2003 session. Its recommendations include 13 proposals to develop a quality education system in Montana, involving full day kindergarten, more support for special needs, gifted and talented, and native American students, regionalization of services, removal of barriers to consolidation, insurance pooling, and more equalized state aid for the district general fund, and more support for quality infrastructure.

OTHER LITIGATION ISSUES

PUBLIC HEALTH AND HUMAN SERVICES – TRAVIS D.

The Travis D. litigation was a class action lawsuit filed by the Montana Advocacy Program (MAP) in 1996 on behalf of individuals with developmental disabilities. On February 5, 2004 a court ordered settlement agreement of this litigation was signed. This settlement agreement contains a number of provisions specific to the developmental disabilities system. In addition to the impact of the settlement agreement on budgetary and public policy related to the developmental disabilities system, it also has potential impacts (budgetary and public policy) on other disability systems. These impacts, issues, and related executive budget requests are discussed in the 2005 Biennium LFD Budget Analysis, Volume 3 for the Department of Public Health and Human Services, pages B-15 and B-30.

PUBLIC HEALTH AND HUMAN SERVICES - M.A.I.D.S. LAWSUIT

In September 2002, the Montana Association for Independent Disability Services, Inc. (MAIDS) and several individuals with developmental disabilities filed suit. The plaintiffs allege that several statutory and constitutional provisions have been violated and seek: 1) to have the wage and benefit disparity between employees of state run institutions and community providers eliminated; and 2) to have uniform Medicaid reimbursement rates established. The court is schedule to hear this lawsuit in August of 2005.

A finding in favor of the plaintiffs and requiring the state to reimburse contractors at a level that provides direct care wage rates that are comparable to state employees would likely have a financial impact on the developmental disabilities system that would be measured in terms of millions of dollars. The potential for similarly situated contractors to file similar legal actions exist. Furthermore, how findings favoring the plaintiffs might impact the definition of employee/employer relationships and other aspects of labor relations and compensation has not been studied.

HIGHWAY PATROL CLASS ACTION LAWSUIT

There was a settlement agreement signed on December 10, 2004 by the state of Montana and the parties representing two lawsuits filed against the state. The first lawsuit is named Swingley, et al. v. Montana Highway Patrol that was filed in district court in the state of Montana. This lawsuit is an administrative wage claim brought to court by certain highway patrol officers for overtime hours. This is a class action lawsuit that includes 323 officers. The case sought overtime compensation for all lunch hours for a period of 3 ½ years and seeks to have overtime and retirement contributions and benefits recalculated based on the contention that subsistence pay, which was to cover meals, travel, uniform maintenance and home telephone for each officer, should have been included in the officers' base pay. The settlement amount for this case was \$7,650,000

The second lawsuit is named Babinecz et al. v. Montana Highway Patrol that was filed in district court in the state of Montana. This lawsuit is was also for certain wage claims brought to court by 16 highway patrol officers. The settlement amount for this case was \$850,000.

Payments will require an affirmative act of the legislature.

CENTRALLY ASSESSED PROTESTED PROPERTY TAXES

Pennsylvania Power and Light (PPL) has protested at least a share of their property taxes every year since tax year 2000. Before the passage of SB 294 during the 2003 session, these taxes were paid into an escrow account and were unavailable for use by the state, local governments, and schools. SB 294 allows the state share of these taxes to be deposited into the general fund for support of governmental services. As of the end of FY 2004, a total of \$5.6 million in protested taxes was deposited in the general fund. It is expected that an additional \$2.6 million will be deposited in FY 2005.

The PPL case is before the State Tax Appeal Board (STAB), which may rule this winter. Regardless of STAB's ruling, this case is likely to be appealed in district court and may take some time to work its way through the court system. There is little risk that the state will lose these funds during the 2005 biennium. However, if STAB rules against the state, there is a distinct possibility refunds would be required during the 2007 biennium.

Due to the uncertainty of this issue, the executive proposes legislation to transfer half of the protested property tax payments (up to a maximum of \$4.0 million) currently in the general fund into a state special revenue account. Money in this account would be used to pay any refunds to companies that are successful in the appeal process.

**LFD
COMMENT**

Senate Bill 294 passed by the 58th Legislature was designed to release centrally assessed protested property taxes that were deposited into a local government escrow account. For local governments, this provided access to the funds while the protest process worked its way through the appeal process. The executive is now proposing to create a state \$4.0 million reserve account to pay unexpected state refunds. It would be more prudent and simpler for the state to merely deposit its share of these protested taxes into a state special escrow account, including, the amounts currently in the general fund. As the protested cases are resolved, the funds in the escrow account are either refunded to the taxpayer or transferred to the state general fund.

TOBACCO SETTLEMENT FUNDS

Montana receives revenue as a settling party to a master settlement agreement (MSA) with four original tobacco companies and 43 subsequent companies that ended a four-year legal battle that included 46 states and 6 other entities. Currently, Montana is eligible for two types of payment: 1) on-going annual payments (to be received April 15th); and 2) strategic contribution payments (from FY 2008 through FY 2017). The MSA places no restrictions on how states are to spend the money.

REVENUE

The total amount of tobacco settlement funds available to Montana may be affected by a number of adjustments. The three most important are the adjustments for inflation, volume of cigarettes shipped nationally, and participating manufacturers' loss of market share. Montana's annual share will increase by a minimum amount of 3 percent or more if inflation is greater than 3 percent. The amount will decrease if the number of cigarettes shipped nationally decreases and will increase if the number increases. Proceeds are reduced if it is proven that participating manufacturers have lost a significant portion of market share due to disadvantages caused by the MSA (participating manufacturers did lose market share in 2003). Figure 1 shows the revenue Montana has received through FY 2004 and amounts expected in FY 2005-2007, as estimated by the Revenue and Transportation Interim Committee. Revenues decline due to reductions required in the MSA, declines in the number of cigarettes shipped nationally, and anticipation that participating manufacturers will withhold a portion of their payments in the 2007 biennium until the cause of the loss of market share is proven. Based on testimony from the Montana attorney general staff, the Revenue and Transportation Interim Committee decided to include in the legislature's revenue estimates a reduction in revenue caused by the loss of participating manufacturers' market shares.

Figure 1
Tobacco Settlement and Tobacco Trust
Revenues and Distributions-2007 Biennium

Tobacco Settlement Revenue Allocations						Tobacco Trust Interest Earnings Allocations		
Current Distribution %	11%	40%	State Special Revenue		100%	90%	10%	100%
Fiscal Year	General Fund	Trust Fund	32% Treat/Prevention	17% CHIPS, CHA	Total	State Special	Tobacco Trust	Total
2000 Actual	\$34,804,411	\$0	\$0	\$0	\$34,804,411	\$0	\$0	\$0
2001 Actual*	15,989,101	10,650,750	0	0	26,639,851	98,519	71,172	169,691
2002 Actual	18,647,411	12,431,607	0	0	31,079,018	1,015,407	22,212	1,037,619
2003 Actual	18,699,611	12,466,407	0	0	31,166,018	1,647,194	160,832	1,808,027
2004 Actual**	2,933,928	10,668,829	8,535,063	4,534,252	26,672,073	2,402,846	266,983	2,669,829
2005 Estimate	2,871,220	10,440,800	8,352,640	4,437,340	26,102,000	2,810,700	312,300	3,123,000
2006 Estimate	2,319,240	8,433,600	6,746,880	3,584,280	21,084,000	3,338,100	370,900	3,709,000
2007 Estimate	2,308,680	8,395,200	6,716,160	3,567,960	20,988,000	3,807,000	423,000	4,230,000
Totals	\$98,573,602	\$73,487,194	\$30,350,743	\$16,123,832	\$218,535,372	\$15,119,765	\$1,627,399	\$16,747,165

* In addition, \$1,143 general fund was recorded as prior year revenue.
** In addition, \$22,189 of interest to the trust was recorded as prior year revenue.

DISTRIBUTION

In FY 2000, the revenue received from the MSA was deposited to the general fund. However, due to passage of Montana Constitutional Amendment 35 by the electorate in November 2000, beginning in January 2001, the legislature was required to dedicate not less than 40 percent of tobacco settlement

money to a permanent tobacco trust fund. Since the legislature has not yet specified in statute the exact percentage to be distributed to the tobacco trust fund, the revenue estimates assume 40 percent. From July 2000 to June 2003, 60 percent of the money was deposited into the general fund. Due to passage of Initiative 146 by the electorate in November 2002, beginning July 2003, 32 percent of the total tobacco settlement money funds tobacco prevention/cessation programs, and 17 percent of the total funds the Children's Health Insurance Program and programs of the Comprehensive Health Association (CHA). SB 485 (17-6-606, MCA), enacted by the 2003 legislature, allows the 32 percent allocation to be used for human service programs and the 17 percent allocation to be used to match federal Medicaid money. These allowances terminate the end of June 2005. Money from both allocations can be used for tobacco disease prevention and to fund the Tobacco Prevention Advisory Board. Money not appropriated within two years is transferred to the tobacco trust fund. The remaining 11 percent of the MSA money is deposited to the general fund. SB 485 authorized the transfer of \$5.8 million in FY 2004 and \$6.1 million in FY 2005 from the account receiving the 32 percent allocation to a newly created prevention and stabilization state special revenue account. Figure 1 also shows actual settlement amounts distributed to the general fund, tobacco trust fund, and state special revenue accounts through FY 2004 and the amounts estimated to be distributed in FY 2005-2007.

Executive Budget Recommendations

The executive is proposing legislation (LC 126) to make the temporary amendments (to 17-6-606, MCA) enacted in SB 485 by the 2003 legislature permanent beginning FY 2006. If enacted by the legislature as proposed:

- Money in the tobacco prevention and control account (32 percent allocation) can be used to fund human services programs in addition to the current law uses
- Money in the CHIP/MCHA account (17 percent allocation) can be used to match federal Medicaid funds in addition to the current law uses
- A portion equal to the amount appropriated from the prevention and stabilization account is transferred to that account from the account receiving the 32 percent allocation of tobacco settlement funds. The transferred amount must be used to fund human services programs.

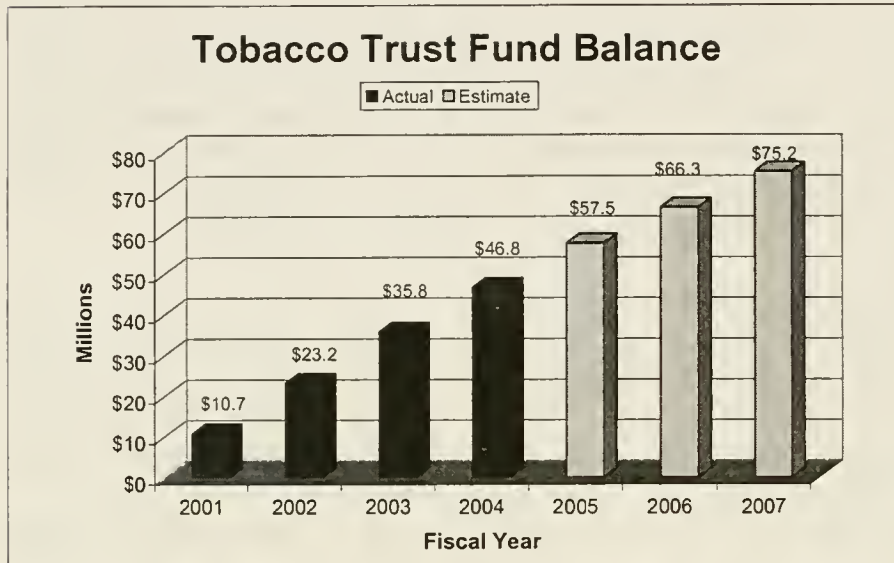
Please see related issues beginning on page B-27 in Volume 3 of the Legislative Budget Analysis 2007 Biennium:

- Fiscal 2005 appropriations of interest earnings from the tobacco settlement trust fund exceed estimated revenues in fiscal 2005
- Fiscal 2005 appropriations and executive requested appropriations from the CHIP/MCHA account (17 percent allocation) exceed estimated revenues in FY 2005-2007
- If the legislature approves the proposed legislation, reductions in appropriations from the prevention and stabilization account would be needed to ensure appropriations do not exceed estimated revenues--if the legislature does not approve the proposed legislation, changes in the source of funding for requested expenditures or reductions in services must be considered

TOBACCO TRUST FUND

As stipulated in the Montana Constitution, interest earnings from the tobacco trust are to be distributed: 1) 90 percent for appropriation by the legislature for disease prevention programs and state programs providing benefits, services, or coverage related to the health care needs of the people of Montana; and 2) 10 percent to the tobacco trust. Money in the tobacco trust can be spent if approved by 2/3 of each house of the legislature. Appropriations of principal, income, or interest from the trust fund cannot be

Figure 2



used to replace state or federal money that supports tobacco disease prevention programs that existed on December 31, 1999. The tobacco trust fund began receiving deposits of settlement proceeds and interest earnings in FY 2001. Figure 2 shows the fiscal year end fund balances through FY 2004 and the balances estimated by the legislature for FY 2005-2007.

CIGARETTE & TOBACCO TAX INCREASE – INITIATIVE NO. 149

INTRODUCTION

On November 2, 2004, the electorate adopted the cigarette and tobacco tax increase contained in Initiative 149 (I-149). This initiative increases the tax on all tobacco products (cigarettes, moist snuff, and other tobacco products) and also changes the distribution of the tax proceeds.

The tax rate on cigarettes is increased from \$0.70 per 20-count pack to \$1.70 per pack, or an increase of 142.9 percent. The tax on moist snuff is also increased from \$0.50 per ounce to \$0.85 per ounce for an increase of 70.0 percent. The tax on all other tobacco products is increased from 25 percent of the value of the commodity to 50 percent of the value, or a 100 percent increase. The effective date of the initiative is January 1, 2005, and applies to all tobacco products received by wholesalers after December 21, 2004. Figure 3 compares the tax rates under the old law versus the new law.

Figure 3
Cigarette and Tobacco Tax Rates
Old Law vs. New Law

Commodity	Unit	Old Law Tax Rate	New Law Tax Rate	Change	Percent Change
Cigarette Tax	Per 20 Count Pack	\$0.70	\$1.70	\$1.00	142.9%
Moist Snuff Tax	Per Ounce	\$0.50	\$0.85	\$0.35	70.0%
Other Tobacco Products	Per Value	25.0%	50.0%	25.0%	100.0%

ESTIMATED REVENUE

The estimated revenue collections shown in Figure 4 are based on the assumptions adopted by the Revenue and Transportation Interim Committee (RTIC) on November 16, 2004. The assumptions used in estimating tobacco taxes included cigarette and tobacco consumption, the change in this consumption due to the increase in the tax rates, and the tribal revenue sharing agreements. The consumption estimates (prior to I-149) were based on Montana adult population and the historical consumption decline rates.

Figure 4
Cigarette and Tobacco Tax Revenue Estimates
Based on Revenue & Transportation Interim Committee Assumptions
Old Law vs. New Law / Fiscal 2005, 2006, 2007
In Millions

	FY 2005 Old Law	FY 2005 New Law	FY 2006 Old Law	FY 2006 New Law	FY 2007 Old Law	FY 2007 New Law	3 Years Old Law	3 Years New Law
Cigarette Tax								
Tribal Payments	0.803	0.803	1.195	1.735	1.166	2.234	3.164	4.772
General Fund	34.639	34.608	33.321	33.193	32.397	32.030	100.357	99.831
Long-Range Building Program	1.704	1.849	1.639	1.914	1.594	1.847	4.937	5.610
State Veterans' Nursing Home *	3.289	4.826	3.164	6.109	3.077	5.895	9.530	16.830
Health & Medicaid Initiatives	0.000	16.867	0.000	32.383	0.000	31.249	0.000	80.499
Totals	\$40.435	\$58.953	\$39.319	\$75.334	\$38.234	\$73.255	\$117.988	\$207.542
<i>Change</i>		<i>\$18.518</i>		<i>\$36.015</i>		<i>\$35.021</i>		<i>\$89.554</i>
Moist Snuff & Other Tobacco Tax								
Tribal Payments	0.085	0.085	0.107	0.163	0.110	0.223	0.302	0.471
General Fund	3.687	3.677	3.760	3.779	3.855	3.847	11.302	11.303
Health & Medicaid Initiatives	0.000	1.861	0.000	3.779	0.000	3.847	0.000	9.487
Totals	\$3.772	\$5.623	\$3.867	\$7.721	\$3.965	\$7.917	\$11.604	\$21.261
<i>Change</i>		<i>\$1.851</i>		<i>\$3.854</i>		<i>\$3.952</i>		<i>\$9.657</i>
All Tobacco Taxes Combined	\$44.207	\$64.576	\$43.186	\$83.055	\$42.199	\$81.172	\$129.592	\$228.803
<i>Change</i>		<i>\$20.369</i>		<i>\$39.869</i>		<i>\$38.973</i>		<i>\$99.211</i>

* The greater of 8.3 percent or \$2.0 million. Excess above \$2.0 million at the end of fiscal year is returned to the general fund.

As shown in Figure 4, total revenues from all tobacco taxes will increase by \$99.2 million over the three-year period FY 2005 through 2007. Of this increase, \$90.0 million will be deposited into the new health and Medicaid initiatives account and the general fund will receive an additional \$6.8 million. The long-range building program and tribal governments will receive \$0.7 million and \$1.8 million, respectively.

DISTRIBUTION

In addition to the tax increases contained in the initiative, it also changes the distribution of cigarette and tobacco taxes and creates a new state special revenue fund called the health and Medicaid initiatives account. This account is to be administered by the Department of Public Health and Human Services. The following is the portion of the initiative that specifically addresses the use of the funds in this new account.

(3) This account shall be used only to provide funding for:

(a) the state funds necessary to take full advantage of available federal matching funds in order to maximize enrollment of eligible children under the children's health insurance program, provided for under Title 53, chapter 4, part 10, and to provide outreach to the eligible children. The increased revenue in this account is intended to increase enrollment rates for eligible children in the program and not to be used to support existing levels of enrollment based upon appropriations for the biennium ending June 30, 2005.

(b) a new need-based prescription drug program established by the legislature for children, seniors, chronically ill, and disabled persons that does not supplant similar services provided under any existing program;

(c) increased Medicaid services and Medicaid provider rates. The increased revenue is intended to increase Medicaid services and Medicaid provider rates and not to supplant the general fund in the trended traditional level of appropriation for Medicaid services and Medicaid provider rates.

(d) an offset to loss of revenue to the general fund as a result of new tax credits or to fund new programs to assist small businesses with the costs of providing health insurance benefits to employees, if these tax credits or programs are established by the legislature after the effective date of this section.

(4) Until the programs or credits described in subsections 3(b) and 3(d) are established, the funding shall be used exclusively for the purposes described in subsections 3(a) and 3(c).

(5) The phrase "trended traditional level of appropriation" as used in subsection 3(c), means the appropriation amounts, including supplemental appropriations, as those amounts were set based on eligibility standards, services authorized and payment amount during the past five biennial budgets.

(6) The department of public health and human services may adopt rules to implement this section.

Figure 5

Cigarette and Tobacco Tax Distribution
Old Law vs. New Law

Cigarette Tax	Old Law	New Law	Change
General Fund	87.4%	45.1%	-42.3%
Long-Range Building Program	4.3%	2.6%	-1.7%
State Veterans' Nursing Home *	8.3%	8.3%	0.0%
Health & Medicaid Initiatives	0.0%	44.0%	44.0%
Totals	100.0%	100.0%	0.0%
Moist Snuff & Other Tobacco Tax	Old Law	New Law	Change
General Fund	100.0%	50.0%	-50.0%
Health & Medicaid Initiatives	0.0%	50.0%	50.0%
Totals	100.0%	100.0%	0.0%

* The greater of 8.3 percent or \$2.0 million.

Figure 5 shows the distribution of the cigarette and tobacco tax under the old law versus the new law. As shown in the figure, the general fund and long-range building program accounts will receive a smaller percentage of the cigarette tax under new law versus old law. The health and Medicaid initiatives account will receive 44.0 percent of the total cigarette tax beginning January 1, 2005. As noted in Figure 2, the state veterans' nursing home account receives the greater of 8.3 percent of the cigarette tax or \$2.0 million. Under the new tax rate, 8.3 percent will be the greater amount. However, 16-11-119(2), MCA states that "if money in the state special revenue fund for the operation and

maintenance of state veterans' nursing homes exceeds \$2 million at the end of the fiscal year, the excess must be transferred to the state general fund."

Figure 5 also shows the distribution of the moist snuff and other tobacco taxes. The general fund account will receive 50.0 percent of these collections beginning January 1, 2005, while the health and Medicaid initiatives account will receive the remaining 50.0 percent.

CONSUMPTION DECLINE

When the \$0.52 cigarette tax increase was enacted during the 58th Legislature (SB407), a price elasticity factor was applied to taxable packs of cigarettes to determine an estimate of the anticipated consumption decline. Price elasticity is simply defined as the predicted consumption response due to a price change in a commodity. An elasticity factor of -0.44 was assumed when the tax rate was increased to \$0.70 per 20-count pack. In FY 2005, however, a higher elasticity factor of -0.80 is assumed. This assumption is based on similar tax increases implemented in other states and the decline in consumption that occurred in those states. Therefore, since the average retail price of cigarettes is expected to increase by about 27 percent, total consumption should decline by nearly 22 percent with the enactment of the higher tax rate. If this consumption response rate is correct, total packs consumed will drop from 60.9 million packs in FY 2004 to about 44.0 million packs by FY 2007. A -0.80 elasticity factor was also applied to other tobacco products.

TAX AVOIDANCE

In addition to the consumption decline described above, the amount of smuggling and across-the-border or internet purchases that will take place has not been factored into the revenue estimates. Based on several studies done on the tax avoidance issue, the reduction in state revenues could be in the range of 5-8 percent of total revenues. To what extent smokers may try to avoid the large tax increase in Montana is unknown. Montana, like other states, may experience a stockpiling effect in November and December with a return to a more normal purchasing behavior once the inconvenience of across-the-border and internet sales becomes tiresome.

According to the Campaign for Tobacco-Free Kids, "every single state that has significantly raised its cigarette tax rate has enjoyed substantial increases to state revenues, despite the fact that cigarette tax

increases reduce state smoking levels and despite any related increases in cigarette smuggling or cigarette tax avoidance.”

STATE COMPARISONS

Figure 6 provides tax rate comparisons among the states. As shown in the figure, Montana has the fourth highest rate in the nation at \$1.70 per 20-count pack. Rhode Island is first at \$2.46, New Jersey is second at \$2.40, and Michigan is third at \$2.00 per 20-count pack. Overall, the “all states’ average” is \$0.84 per 20-count pack. Figure 7 shows the tax rates by state but in map form. As shown on the map, the states surrounding Montana are significantly below Montana’s tax rate. Washington and Oregon are the closest at \$1.42 ½ and \$1.18 per 20-count pack, respectively.

Figure 6

STATE CIGARETTE EXCISE TAX RATES & RANKINGS

Overall All States' Average: 84.0 cents per pack
Major Tobacco States' Average: 15.3 cents per pack
Other States' Average: 93.1 cents per pack

State	Tax	Rank
Alabama	42.5	39th
Alaska ¹	160	5th
Arizona	118	13th
Arkansas	59	29th
California	87	21st
Colorado ²	84	22nd
Connecticut	151	6th
Delaware	55	32nd
DC	100	16th
Florida	33.9	44th
Georgia	37	41st
Hawaii ³	140	10th
Idaho ⁴	57	30th
Illinois	98	19th
Indiana	55.5	31st
Iowa	36	42nd
Kansas	79	24th
Kentucky	3	51st

State	Tax	Rank
Louisiana	36	42nd
Maine	100	16th
Maryland	100	16th
Massachusetts	151	6th
Michigan	200	3rd
Minnesota	48	37th
Mississippi	18	47th
Missouri	17	48th
Montana ⁵	170	4th
Nebraska	64	27th
Nevada	80	23rd
New Hampshire	52	36th
New Jersey	240	2nd
New Mexico	91	20th
New York	150	8th
North Carolina	5	50th
North Dakota	44	38th
Ohio	55	32nd

State	Tax	Rank
Oklahoma ⁶	103	15th
Oregon ⁷	118	13th
Pennsylvania	135	11th
Rhode Island	246	1st
South Carolina	7	49th
South Dakota	53	35th
Tennessee	20	45th
Texas	41	40th
Utah	69.5	26th
Vermont	119	12th
Virginia ⁸	20	45th
Washington	142.5	9th
West Virginia	55	32nd
Wisconsin	77	25th
Wyoming	60	28th
Puerto Rico	103	15th
Guam	118	13th
Northern Marianas	135	11th

¹ Effective 1/1/05.

² Effective 1/1/05.

³ Scheduled to revert to \$1.00 on 7/1/05.

⁴ Scheduled to revert to 28¢ on 7/1/05.

⁵ Effective 1/1/05.

⁶ Effective 1/1/05.

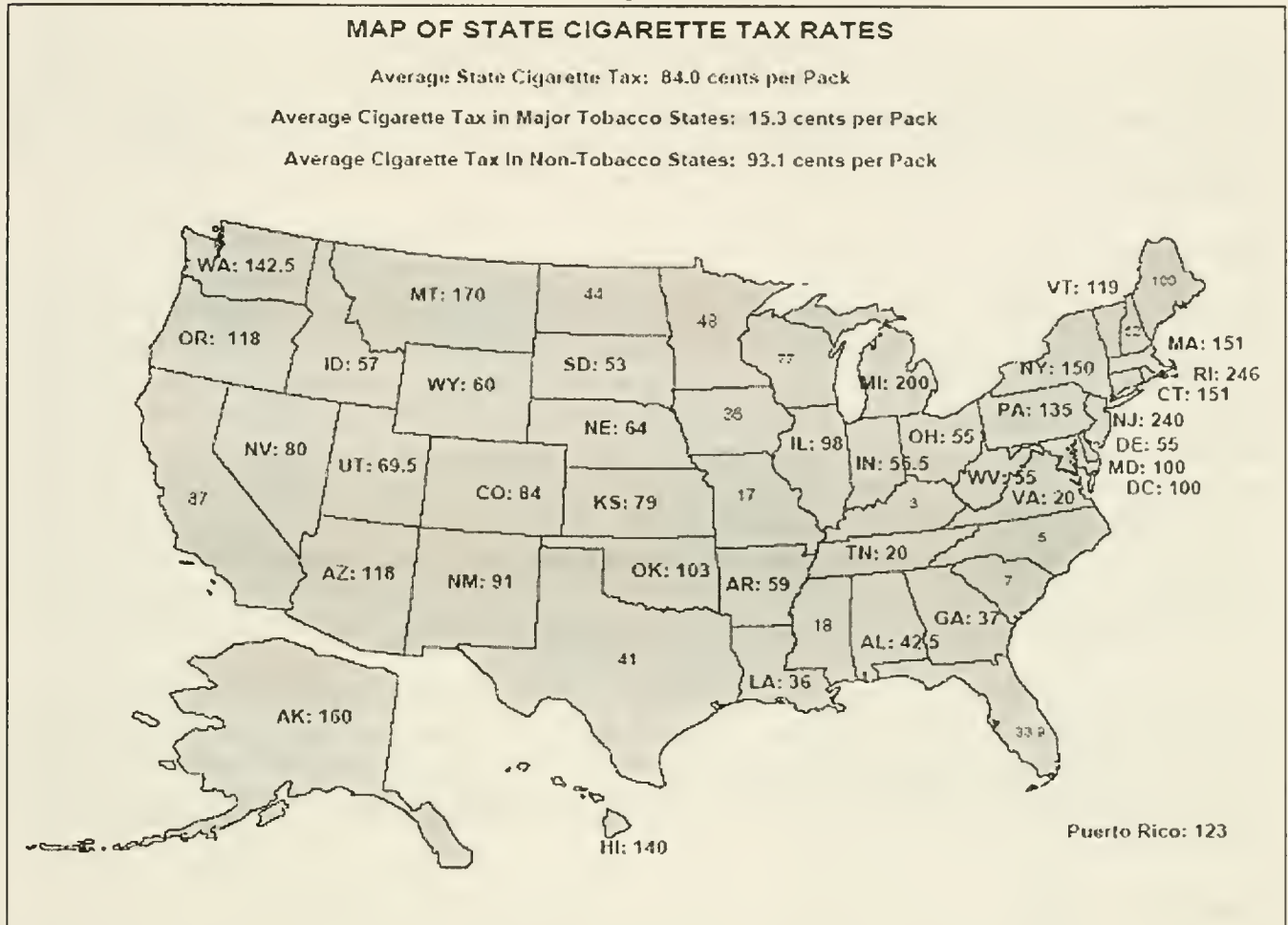
⁷ Temporary 10¢ increase expired 1/1/04.

⁸ Effective 9/1/04, with 10¢ increase on 7/1/05.

TOBACCO ALLIANCE

After passage of I-149, a group called the Tobacco Alliance began meeting to develop and present a plan to the 2005 Legislature to implement the initiative. The group includes representatives of the Governor-Elect, the State Auditor, the American Cancer Society, AARP (American Association of Retired Persons), Montana Nurses Association, hospitals, nursing homes, and other parties. The group formed four subcommittees to work on specific recommendations for the Children's Health Insurance Plan (CHIP), small business health insurance, prescription drugs, and Medicaid provider rates. The plan had not been finalized of November 2004.

Figure 7



USE OF DONATIONS AS STATE MATCH FOR CHIP

Press reports in late November 2004 noted that the executive budget included private donations for CHIP match as a “place holder” in anticipation of passage of I- 149. A portion of the health and Medicaid initiatives account is to be used to maximize enrollment in the CHIP program and may only be used for CHIP match. The statute further states that the funding in the account...“is intended to increase enrollment rates for eligible children in the program and not to be used to support existing levels of enrollment based upon appropriations for the biennium ending June 30, 2005.” (53-6-206(3)(a), MCA). The language in the initiative directs “non-supplantation” of existing state matching CHIP revenues with the new cigarette tax revenues.

LFD staff discussed, with legislative legal staff, the meaning of 53-6-2-6(3)(a), MCA. Legal staff concluded that the language is clear. Funds from the \$1 per pack cigarette tax must be used for increased CHIP enrollment above the FY 2005 appropriation level. If the legislature accepts the executive premise that base level CHIP program expenditures be funded from increased cigarette tax revenues, 53-6-2-6(3)(a), MCA should be amended to allow such a use.

FEDERAL JOBS AND GROWTH TAX RELIEF FUNDS OF 2003

In response to severe fiscal shortfalls experienced by almost all states in FY 2002 and FY 2003, Congress passed legislation providing fiscal relief to states. Called the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Jobs and Growth), the legislation consisted of two types of fiscal relief: 1) a temporary increase in the federal Medicaid benefits participation rate; and 2) a general use block grant of \$50 million.

MEDICAID

The Medicaid program, which provides medical care to low-income persons, is funded with a combination of federal and state funds. Federal funds provide the bulk of the funding, and are matched by state revenues. When the legislature estimates Medicaid costs, it applies the estimated federal Medicaid matching rate to determine the federal appropriation, and appropriates general fund to fund the state responsibility. In order to reduce state costs for Medicaid, the Jobs and Growth act increased the federal Medicaid matching rate for the period of March 2003 (FY 2003) through fiscal year end 2004 (June 30, 2004) by 2.95 percentage points (to 75.91 percent in FY 2004 from the originally estimated 72.96 percent). Consequently, the state required less general fund to fund Medicaid than had been appropriated. The Department of Public Health and Human Services (DPHHS) reverted about \$4 million in FY 2003 and about \$14.4 million in FY 2004 to the general fund due to the lower match rate.

Because the lower rate was in effect throughout the base year FY 2004 expenditures, federal funds are overstated and general fund understated. The 2007 executive budget replaces federal funds no longer available with general fund in order to maintain services. For a further discussion, see the Department of Public Health and Human Services in Volume 3 of the Legislative Budget Analysis 2007 Biennium (page B-9).

GRANT

The federal government also provided \$50 million total (\$25 million in each of FY 2004 and FY 2005) for use by the states for any purpose meeting the following criteria:

- To provide essential government services
- To cover the costs to the state of complying with any unfunded federal mandates

The funds could only be used for expenditures “permitted under the most recently approved budget for the state”, meaning they could not be used to fund new programs not already funded.

As a condition of the grant, the federal government required that all funds be obligated by September 30, 2004. The Governor fulfilled this requirement when she identified a number of activities for augmented funding, and obligated the remainder of the \$50 million for wildfire costs. After a mild fire season in fall 2004, funds originally obligated for wildfires are now available for re-allocation.

The Governor was able to make these allocations (\$49.85 million) under the budget amendment statutes. No further allocations can be made by the Governor once the legislature is in session and able to act.

Figure 8
Governor's Proposed or Actual Allocations
Federal Relief Funds
2005 Biennium

Function	Fiscal 2004	Fiscal 2005	Biennium
<u>Expended</u>			
Fire Costs***	\$34,827,143	\$2,252,938	\$37,080,081
<u>Authorization</u>			
Defense in Bankruptcy Hearings*			
Public Service Commission**	\$354,685		\$354,685
Department of Justice**	<u>712,385</u>		<u>712,385</u>
Subtotal Bankruptcy Hearings	\$1,067,070		\$1,067,070
Governor's Office			
Extradition of Prisoners		\$40,000	\$40,000
Economic Development made in Montana		<u>25,000</u>	<u>25,000</u>
Subtotal Governor's Office	\$0	\$65,000	\$65,000
Department of Livestock			
Meat Inspector		23,031	23,031
Department of Natural Resources and Conservation			
Water Rights Data Base		\$100,000	\$100,000
Helicopter	<u>150,000</u>		<u>150,000</u>
Subtotal DNRC	\$150,000		\$250,000
Department of Military Affairs			
Winter Storm Emergency	249,682		249,682
Department of Corrections			
Room and Board		1,000,000	1,000,000
Health and Human Services			
Meals on Wheels	\$257,000	\$257,000	\$514,000
Low Income Energy Assistance*	2,000,000	0	2,000,000
Reduce vacancy savings at institutions	<u>750,000</u>	<u>750,000</u>	<u>1,500,000</u>
Subtotal Human Services	\$3,007,000	\$1,007,000	\$4,014,000
K-12 Education*			
Technology Fund	\$1,750,000		\$1,750,000
Reading in the early school years grants	450,000		450,000
Vocational Education	250,000		250,000
OPI - Technical assistance for No Child Left Behind	50,000		50,000
OPI - Curriculum development for Indian Cultural Heritage	50,000		50,000
Renewal Commission	25,000		25,000
Reduce vacancy savings for Montana School for the Deaf and Blind	<u>125,000</u>	<u>116,046</u>	<u>241,046</u>
Subtotal K-12 Education	\$2,700,000	\$116,046	\$2,816,046
Capital Projects*			
Room Renovation		133,121	133,121
Repair Capitol steps	<u>450,000</u>		<u>450,000</u>
Subtotal Capital Projects	450,000	133,121	583,121
Montana University System*			
General with requirement to indicate how it will be distributed	\$2,000,000		\$2,000,000
Community Colleges	450,000		450,000
Distance Learning	<u>250,000</u>		<u>250,000</u>
Subtotal Higher Education	<u>\$2,700,000</u>		<u>\$2,700,000</u>
Total Federal Funds	<u>\$45,150,895</u>	<u>\$4,532,136</u>	<u>\$49,848,031</u>
Remainder			\$151,969

*Biennial appropriation.

**All expenditures have been reimbursed by Northwestern Energy.

***Includes estimate of Spring 2005 fire costs and the net of a payback of \$222,890 in the Department of Military

These expenditures are all considered one-time-only and are not included in the FY 2004 base used as the starting point for 2007 biennium budget building. The Governor has not requested replacement of any of the functions with general fund, although Governor Martz has requested general fund of almost \$500,000 to plan for implementation of Indian Education for All, and \$570,000 to augment career and vocational technical education. Both proposed appropriations are in the Office of Public Instruction. State responsibility for fire suppression costs would again be funded with general fund absent any other action by the 2005 Legislature.

As shown in the table, almost \$152,000 remains unallocated, and available for legislative appropriation. In addition, additional funds could become available prior to the end of the fiscal year through either of two means:

1. Funds currently obligated for the remainder of FY 2005 fire suppression costs could remain unspent depending upon the severity of the remainder of the fire season
2. Funds allocated for a number of purposes could also remain unspent

The legislature may wish to be kept apprised of actual and proposed expenditures from the account throughout the legislative session.

STATEWIDE PUBLIC DEFENDER SYSTEM

The Law and Justice Interim Committee voted to introduce legislation in the 2005 legislative session to provide a statewide public defender system, which could have a significant fiscal impact on the District Court Operations Program. This legislation, LC 214, is partially in response to a lawsuit filed in district court by the ACLU against the State of Montana and Missoula County. The ACLU alleges that defendants are not being provided public defender services in a fair and consistent manner among jurisdictions. Also, the ACLU argues that the current system creates a conflict of interest when the judge appoints a public defender for a case that is being adjudicated by that judge. The attorney general and the ACLU signed a stipulation placing the lawsuit on hold until May 2005, pending the actions of the legislature and outcome of the proposed legislation. If this legislation were passed, current assumptions project that approximately \$8.2 million would be moved from the District Court Assumption Program to the Chief Public Defender Office, at the beginning of FY 2007, and additional costs to staff the central office would be incurred. This office would oversee the statewide public defender system and is proposed to reside within the Department of Administration.

The system proposed in LC 214 would provide public defender services in criminal and certain civil cases for any individual who is: 1) determined to be financially unable to retain private counsel; and 2) accused of an offense that could result in the person's loss of life or liberty if the person is convicted. The proposed system would provide public defender services in the Supreme Court or in any district court, justice court, or city or municipal court in the state. A Public Defender Commission, comprised of seven individuals appointed by the Governor, would head the statewide system. The commission would oversee a Chief Public Defender Office responsible for managing regional public defender offices, contracts with private attorneys, and the appellate defender function.

Figure 9 Estimated Costs of the Statewide Public Defender System for the 2007 Biennium		
	Amount	Percent
Current Costs*	\$10,604,998	75%
New Costs**	3,495,805	25%
2007 Biennium	<u>\$14,100,803</u>	<u>100%</u>
Fiscal 2006 (transition year)	\$655,503	
Fiscal 2007 (first full year)	13,455,300	
One-Time (start-up) costs	548,731	
Ongoing new costs (annual)	2,947,074	
*Currently paid by either the state, city or county		
**Mostly those of the Chief Public Defender Office		

The current estimate of the cost of the public defender system for the 2007 biennium is \$14.1 million. Figure 9 illustrates the level of new costs that mostly relate to the establishment and operation of a Chief Public Defender Office vs. costs that are currently being paid for by either the state or by the collective counties and cities.

Figure 10 Public Defender Costs Currently Funded				
Entity	Item	Dollars	Dollars	Percent
State				
	Funds certain district court costs		\$8,153,295	77%
Counties				
	Funds certain district court costs	\$674,157		
	Funds justice court costs	1,040,000	1,714,157	16%
Cities				
	Funds city and municipal court costs		<u>737,546</u>	<u>7%</u>
Total Costs Currently Funded			<u>\$10,604,998</u>	<u>100%</u>

Figure 10 illustrates how current public defender services are funded. These costs include payments for public defender services provided by seven county-managed public defender offices through the state, services provided by private attorneys, transcripts, private investigator services, and witness fees and

expenses. The amount noted in the table as state costs are those costs that currently reside within the District Court Assumption Program under the operating costs area.

FY 2006 would be a year of transition, whereby the commission and the chief public defender would undertake a process to convert the current system of services provided by the state and the collective counties and cities, to one that provides services on a statewide system. Figure 11 illustrates the costs for the system under a biennium without a transition period.

LC 214 proposes that the costs of the statewide system be shared by the state and by each county and city. The percentage that each entity currently contributes to the total costs of the current system forms the cost sharing formula. Therefore, the costs of the statewide system would be allocated as follows: 1) about 77 percent to the state; 2) about 16 percent to the counties; and 3) about 7 percent to the cities. The county cost allocation factors would be based on: 1) population; 2) taxable value; and 3) the number of index crimes committed in the county. The city cost allocation factors would be based on: 1) population; and 2) taxable value. Implementation language in the legislation instructs the commission to recommend how these cost allocation factors could be changed to include an actual caseload factor when accurate caseload data becomes available.

Figure 11		
Estimated Costs of the Statewide Public Defender System for a Biennium Without a Transition Period		
Dollars in Millions		
Item	Amount	Percent
Current Costs*	\$21.2	78%
New Costs**	<u>5.9</u>	<u>22%</u>
	<u>\$27.1</u>	<u>100%</u>
*Currently paid by either the state, city or county		
**Mostly those of the Chief Public Defender		

DISTRICT COURT ASSUMPTION

The 57th Legislature approved Senate Bill 176, which mandated state funding of Montana district courts with general fund revenue beginning July 1, 2002 that was previously funded by the counties. On that date, the Judiciary assumed the responsibility for oversight and administration of 22 judicial districts with approximately 245.00 FTE. The bill made district courts part of the Judicial Branch of state government. The assumption of district courts did not include the clerks of court and public defenders, although costs to pay for indigent defense were assumed by the state. Costs of the district courts statewide assumption are divided into fixed and variable. Variable costs include juror and witness fees and expenses and indigent defense costs. Indigent defense costs comprise over 80 percent of total variable costs.

The Supreme Court's assumption of the district courts has presented significant fiscal challenges, including a cost overrun resulting in a supplemental funding request of \$5.8 million, an over 25 percent growth, for FY 2005. This supplemental is mostly due to expenditures for public defender services provided by appointed, contracted or county-managed public defenders. See the "Fiscal 2005 Supplemental" section of the Judiciary narrative on page A-18 of Volume 3. The additional costs are not associated with any major, non-recurring case, and as a result, the increased costs will continue into the future unless there are significant changes.

Further, budget reporting by the Judiciary does not allow for an easy identification of the reasons for variances, as variable costs are not budgeted at the judicial district level. The individuals that manage these districts have limited knowledge of the level of spending that is taking place within their jurisdiction. They can create expenditures; however, they do not have a budget to guide the level of expenditure. Budget reporting is also not at a level to easily identify variances for expenditures related to public defense and other costs.

The state cost of the district court assumption is significantly higher than the amount envisioned in the fiscal note for SB 176 in the 2001 session, and there is no clear resolution of this issue, since variable costs continue to be unpredictable and cost controls continue to be weak. This issue should remain on the legislature's "watch" list as a potential budget breaker. The legislature may wish to request that the Judiciary allocate the budget to a level that would allow for the management of cost and easy identification of variances.

MEDICARE MODERNIZATION ACT

The federal Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) was signed into law in December 2003. The most significant change, due to passage of the MMA, is the addition of an outpatient prescription drug benefit (Part D) for Medicare beneficiaries. Despite state and federal implementation issues, outpatient drug assistance is a significant benefit for Medicare beneficiaries. To date, there are many undefined aspects of the MMA, including the underlying data needed to calculate the fiscal effects.

THE DIFFERENCE BETWEEN MEDICARE AND MEDICAID

Medicare and Medicaid are two national programs that provide health care to several groups of persons. Medicare is 100 percent federally funded and provides certain health care services to persons 65 and older and certain disabled persons who meet federal social security disability criteria. On the other hand, Medicaid is jointly funded by states and the federal government, with the federal cost share determined by a state's per capita income compared to national per capita income.

There are three general categories of Medicaid eligibility:

- Aged – over the age of 65
- Disabled or blind (must meet federal social security disability criteria)
- Family (must have dependent children)

In general, an able bodied, childless adult over the age of 21 is not eligible for Medicaid regardless of income.

Medicaid is means tested, meaning that all persons must meet financial and resource eligibility tests. Montana Medicaid eligibility criteria, in most instances, are at or near the federal minimum requirements. The most generous financial eligibility levels are for pregnant women and young children, who can have incomes up to 133 percent of the federal poverty level. Otherwise, children can be eligible for Medicaid in families with incomes up to 100 percent of the federal poverty level, while their parents are eligible for Medicaid only if family income is below 39 percent of the federal poverty level.

Dual Eligibles and Drug Coverage

Aged and disabled persons who are eligible for Medicaid are generally eligible for Medicare as well. The new Medicare Part D prescription drug benefit will have an impact on state Medicaid programs due to these dually eligible persons, because the Montana Medicaid program covers outpatient prescription drugs, while historically Medicare has not. Dually eligible persons will maintain all of their current Medicaid covered services, except drug coverage, which will be provided through Medicare funded prescription drug plans.

The interaction of state Medicaid programs with the new Part D benefit will:

- Impose new state administrative duties
- Offset some of the costs of Medicaid drug costs
- Provide payments to state health plans for qualified retiree drug coverage

Implementation During the 2007 Biennium

The Part D benefit will be implemented January 1, 2006, so MMA requirements for state administrative duties, payments for retiree coverage, and cost sharing will be effective for three quarters of the 2007 biennium. The 2005 Legislature will deal with several impacts of the MMA that are common to all states. At this point, is not possible to tell whether Montana will experience a net gain or loss in general fund costs due to offsetting aspects of the MMA, and it is not evident how fiscal and policy issues associated with the MMA will be addressed in the executive budget request or legislative package.

Impacts to States

The major state fiscal and public policy issues are:

- General fund savings due to federal assumption of prescription costs for some Medicare eligible persons currently eligible for and receiving Medicaid or Mental Health Services Plan (MHSP) prescription drug benefits
- General fund costs from state payments to the federal government for the Medicaid drug cost savings (the “clawback”)
- Increased Medicaid costs due to new enrollees discovered during Part D outreach (the “woodwork effect”)
- General fund costs if the state opts to provide a “wrap around” benefit for potential or known Medicare prescription coverage gaps
- Administrative and workload impacts to provide low-income eligibility determination, beneficiary education, grievance resolution, and coordination with the Social Security Administration
- Potential for federal reimbursement of 28 percent of allowable costs for state health plan insurance coverage for drugs for Medicare eligible employees and retirees

These issues are discussed in greater detail in the budget overview for the Department of Public Health and Human Services, Volume 3, page B-16.

Many Unknowns

There are three federal agencies involved in administration and implementation of the MMA:

- Centers for Medicare and Medicaid Services
- Social Security Administration
- Office of Civil Rights

As of November 2004, only one of the federal agencies – Center for Medicaid and Medicaid Services – had published draft rules to implement the MMA. At this point, and maybe even as of the end of the 2005 legislative session, there maybe little guidance available to states to estimate the cost savings or workload and cost increases due to the MMA. The legislature will need to consider appropriation and policy issues that may require action without sufficient federal guidance to know potential impacts with much certainty.

LONG-TERM STABILITY OF GENERAL FUND

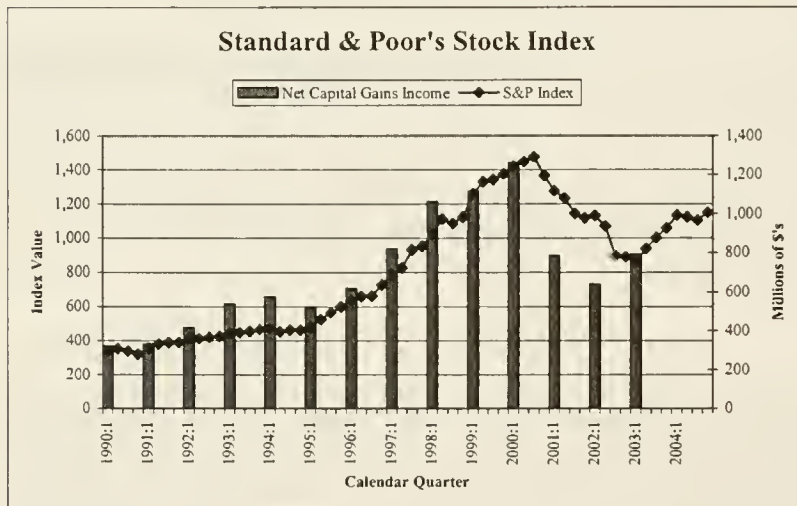
INTRODUCTION

The state general fund is the primary account that funds a significant portion of the general operations of state government. Since this fund is critical to the operations of state government, the long-term stability of this account is an issue that must be examined for development of sound fiscal policies. This section of the document discusses three key issues relevant to the ensuing legislative session and the necessary planning for subsequent sessions. The issues addressed are: 1) revenue stability; 2) reliance on federal funds; and 3) funding demands.

REVENUE STABILITY

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. During calendar 2002 and 2003, however, the state's financial picture blurred as the effects of a national economic recession, terrorism threats, and mid-east tensions played havoc on the US economy. Although Montana's economic base remained relatively stable during this period, state general fund revenues plummeted. This inconsistency was due to the precipitous fall in equity markets, low interest rates, and reduced corporate profits. All of these factors contributed to the 2002/2003 budget crisis while the state's economy continued to outperform the national economy.

Figure 12



As Montana moves forward into the next century, there are valuable lessons that can be extracted from the financial experiences of the 1990's. For example, as the information technology age was exploding during the nineties, the equity markets were experiencing phenomenal growth rates.

As shown in Figure 12, the S&P stock index reached a high of almost 1,500 in calendar 2000 and then declined abruptly until 2003 when the index dropped to about 850. Figure 12 also shows the corresponding

trend in net capital gains realizations as reported on Montana's tax returns. As the figure shows, the trends in reported net capital gains income is highly correlated to the S&P index. This means that state tax revenues experienced significant growth from the mid to late nineties due to the information technology euphoria. In the meantime, while this growth scenario was occurring, state general fund expenditures were increased along with passage of significant tax relief measures. The actions of the legislature, in essence, expanded the expenditure base and reduced the tax base based on the assumption that strong revenue growth would continue indefinitely. Obviously, the budget crisis of

2002/2003 refuted this supposition.

For the 2005 and 2007 biennia, a similar situation may be developing. Montana's oil and natural gas revenues are increasing significantly when compared to previous biennia. The issue is whether these increased revenues are "on-going" or are a short-term "blip" (similar to net capital gains income) that may fade in the future.

Figure 13

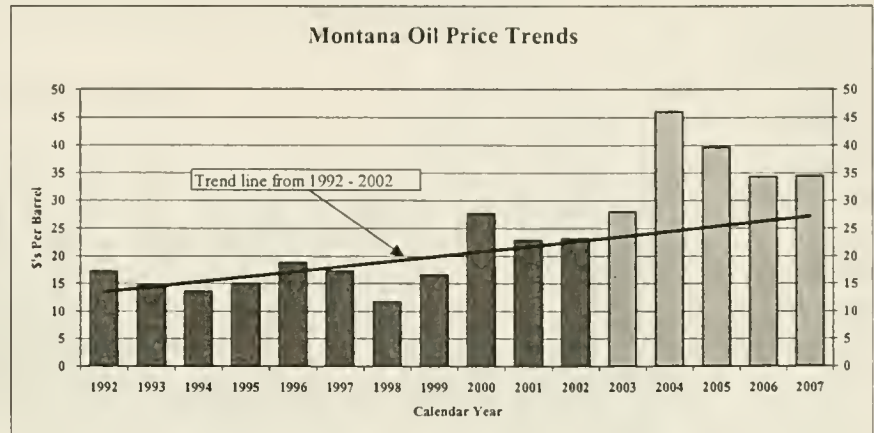
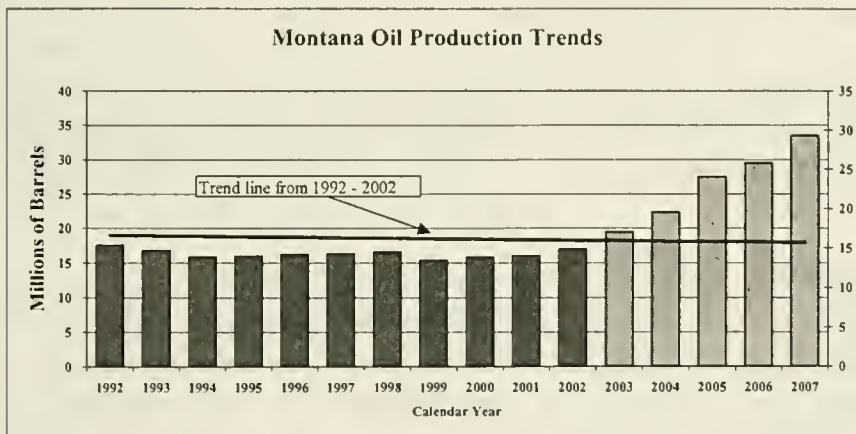


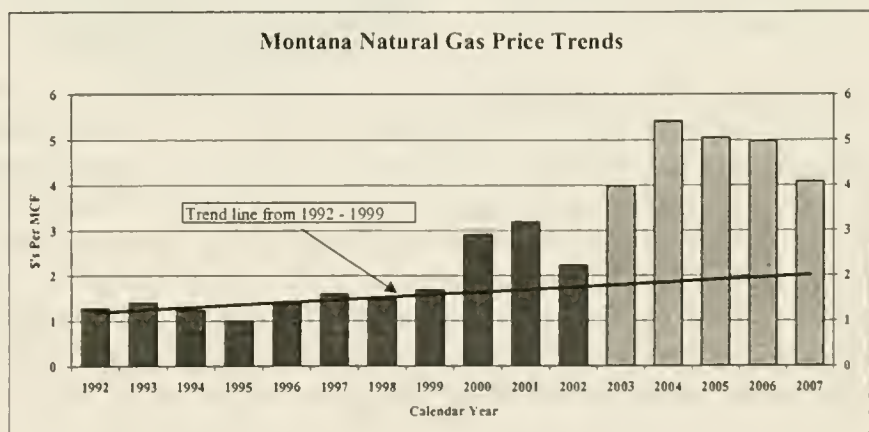
Figure 14



Figures 13, 14, 15 and 16 show the trends in Montana's price and production for oil and natural gas. The data shown for calendar 1992 through 2003 are actual information extracted from the Department of Revenue's computer system. The estimates shown for the period calendar 2004 through 2007 are based on assumptions adopted by the Revenue and Transportation Committee (RTIC) on November 16, 2004.

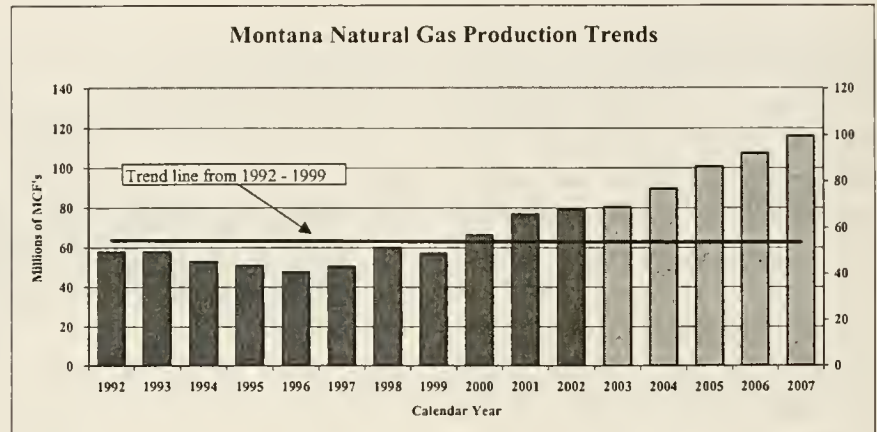
In addition to the actual and estimated amounts, the figures also show a trend line based on the calendar years indicated in the annotations. These trends are based on a common statistical technique

Figure 15



The RTIC was aware of these developments and adjusted the price and production assumptions accordingly. As shown in the figures, it is quite apparent that the price assumptions adopted by RTIC are expected to peak and then begin to trail off by the end of calendar 2007. Based on this outlook, it could be argued that a significant amount of additional revenue in the next several years could be considered “one-time” and will not be available in subsequent biennia. If this hypothesis is correct, the 59th Legislature should consider creating a “rainy day fund” and transferring a portion of the potential one-time revenue into this fund. It is estimated that the additional revenue due to price and production being above the trend lines could be as much as \$80 million general fund or \$180 million all funds for calendar 2006 and 2007. These estimates most likely represent a maximum estimate since the probability of price and production amounts returning to the trend line amounts are low. Bottom line, the legislature should be prudent in utilizing these potential one-time revenues for the 2007 biennium budget.

Figure 16



RELIANCE ON FEDERAL FUNDS

General fund expenditures have increased on average over 4.5 percent from fiscal 1990 to 2004. Correspondingly, federal funds expended have increased over 9.5 percent during this same period. In both funds, however, there have been some budgetary changes that skew these percentages. For example, HB124 (local government entitlement legislation), diverted some local government revenues to the state treasury in return for a state general fund entitlement appropriation to local governments. This change increased general fund revenues by approximately the same amount of increased general fund expenditures. During the 2003 biennium, the state food stamp program was included in the budgeting process. Prior to this time, this program was considered “off budget” and was not included as a federal fund expenditure.

Regardless of these changes, the fact remains that federal funds continue to be a much larger portion of the total state budget. As shown in Figure 17, general fund expenditures represented over 60 percent of the combined general and federal fund expenditures in FY 1990. By FY 1999, the percentage split was about equal. By FY 2004, however, federal funds represented over 55 percent of the combined spending to about 44 percent from the general fund. Total federal funds expended in FY 2004 was \$1.597 billion compared to \$1.282 billion general fund, for a difference or gap of \$315.3 million. If Montana was to lose some or all of this gap, the impact on the services provided to the citizens would be significantly reduced. To maintain the same level of services would require a substantial change in state tax policy.

Figure 17

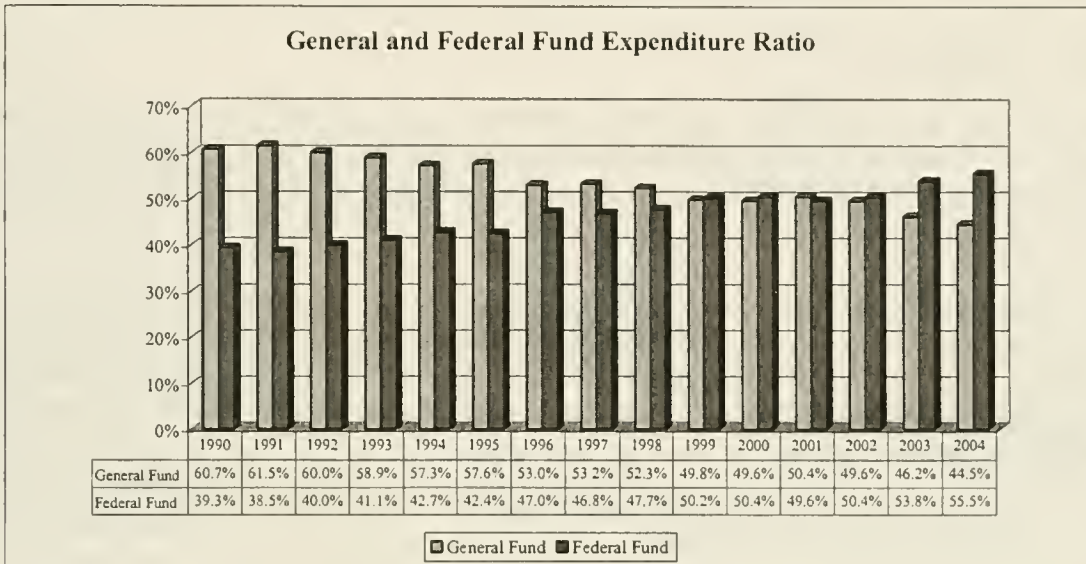
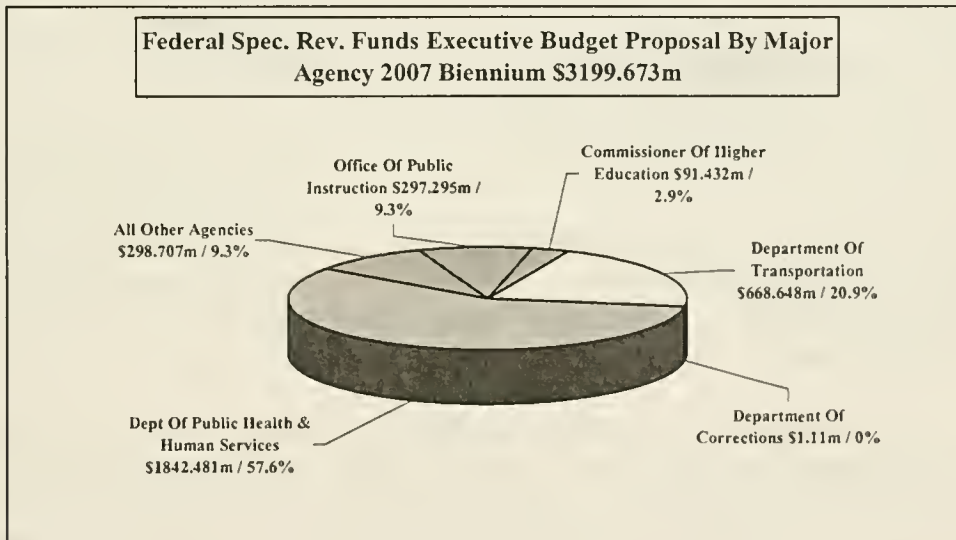


Figure 18 shows the 2007 biennium executive budget recommendation for federal special revenue funds. As the figure shows, public health and transportation services consume almost 80 percent of the federal funds recommended in the executive budget. A reduction in federal funding would have a significant impact to these state programs.

Figure 18



On Friday, December 17, 2004, the "Great Falls Tribune" printed an article on the outlook for President Bush's proposed federal budget. According to President Bush, "What I'm saying is we're going to submit a tough budget. And I look forward to working with Congress on the tough budget". According to this article, President Bush is ready to propose freezing or even slightly cutting overall domestic spending. With federal deficits hovering around \$400 billion and the continued Iraq war funding demands, the prospect for federal funding freezes or reductions are a real possibility, not only in the

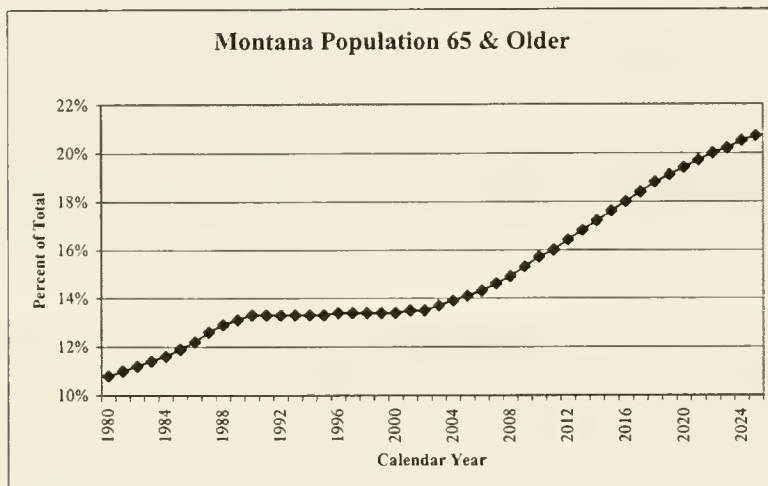
near-term but also in the long-term. The 59th Legislature may want to consider developing a long-range plan in the event of a reduction in federal funds.

FUNDING DEMANDS

Businesses as well as government constantly experience the changing and competing demands for available dollars. Whether a business is contemplating expansion or technology enhancements, state government experiences the same type of needs and priorities in order to continue services to the citizenry of the state.

One of the most significant events that is beginning to surface in Montana is the projected increase in the aging population. Between 2002 and 2024, Montana's population 65 and older is expected to increase from 13.5 percent of the total population to 20.5 percent, or a change in older residents in excess of 80,000. As shown in Figure 19, Montana experienced rapid growth in this age cohort from calendar 1980 to 1990.

Figure 19



Starting in calendar 1991 through 2002, this trend waned with the percentage of residents in this age bracket remaining quite constant. From calendar 2002 to 2024 this trend is once again changing showing a significant percentage of Montana's total population in the 65 and older age range. If these projections are correct, by calendar 2024 one out of every five Montanan's will be at least 65 years old.

between 1946 and 1965. Montana, like other state and local governments, will need to address the issues relative to changing demographics. As Montana's population ages, issues relative to an economy that will be required to support these changes and the implications for medical and long-term care costs must be addressed.

The primary cause of this rising population change is the maturing of the baby-boomer generation, born

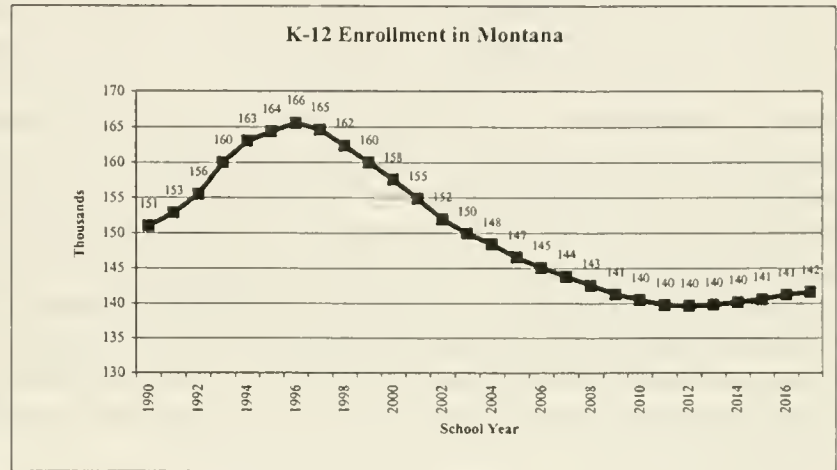
With a growing elderly population, the legislature will need to address how the working-age population can support a significantly older population. In addition to the associated costs of caring for the elderly, the level of income these individuals have and ultimately how much they will pay in taxes could have a substantial impact on state government finances. Given the expected dramatic changes in the age structure of our population, it is imperative the legislature begin thinking about these issues and how they may be addressed in the future.

In addition to our aging population, Montana has experienced a significant change in enrollment in our elementary and secondary public schools. As shown in Figure 20, Montana's total enrollment was in excess of 165,000 children in school year 1996. From this time forward, total enrollment is expected to decline to about 140,000 students by school year 2010. Beyond 2010, enrollment is estimated to increase, but at a fairly moderate rate. The significance of this change is the costs associated with funding our current public school system. Under current law, state expenditures for public schools are

primarily driven by the enrollment in each district. If enrollment declines, then the cost to fund education correspondingly declines. See page 119 for a discussion on the current public school funding lawsuit.

Figure 20

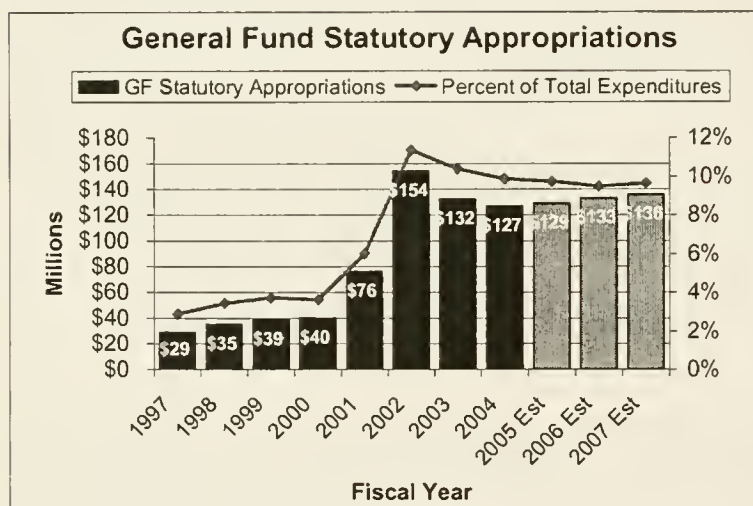
If the current public school funding formula continues to be enrollment driven, the cost of funding the public school system will begin to accelerate when the current enrollment trends reverse direction beginning in school year 2012. At an average cost of about \$3,500 per enrollee per year, small changes in enrollment can turn into significant funding increases in the future.



GENERAL FUND STATUTORY APPROPRIATIONS

Statutory appropriations are a special kind of legislative appropriation. Unlike temporary appropriations that expire in two years (such as those in the general appropriations act), statutory appropriations are, as their name suggests, in statute and are not part of the biennial budgeting process. As such, they are not automatically reviewed by the legislature and are not subject to the priority setting process like temporary appropriations (such as those in HB 2). Since the appropriations are in statute, they remain in place until removed or changed by legislation. The legislature has made various attempts to not lose sight of these appropriations. In 1985, Representative Bardanoue sponsored legislation that required all valid statutory appropriations to be contained in a list in 17-7-502, MCA. That list provides statutory citations for each statutory appropriation. Although there are currently 73 sections listed, some sections have multiple statutory appropriations and each appropriation listed in statute could have multiple appropriations established on the state accounting system. Of these, 16 sections statutorily appropriate general fund. In 1993, Senator Grosfield successfully sponsored legislation (SB 378) that required a review of all statutory appropriations every two years by the Legislative Finance Committee. This requirement was removed by the 2001 legislature. Statutory appropriations are intended for only limited situations, and guidelines for the appropriateness for establishing them are specified in 17-1-508, MCA.

Figure 21



The significance of statutory appropriations lies not in the number of them, but rather in the amount of money authorized to be spent and if the authorizations still reflect the priorities of the current legislature. All statutory appropriations are available for the legislature to review, prioritize, and change if desired. Figure 21 on the left illustrates the amount of general fund spent through statutory appropriations from FY 1997 through FY 2004 and estimated amounts from FY 2005 to FY 2007. From FY 1997 to FY 2004, general fund expenditures from statutory appropriations increased \$98 million and, in FY 2004, comprised 10 percent of all

general fund expenditures. For the 2007 biennium, \$269 million general fund is expected to be spent with statutory appropriations. The initiation of the county entitlement program in FY 2002 (enacted by HB 124 in the 2001 session) accounts for most of the large increase shown in FY 2002. The increase in FY 2001 is largely due to payment of wildfire costs from the summer of 2000.

Figure 22 shows each individual general fund statutory appropriation that has been included in the general fund balance sheet for FY 2005-2007. The largest statutory appropriation of general fund occurs under 15-1-121, MCA. For the 2007 biennium, \$173 million is expected to be spent for entitlement payments to counties and tax increment financing districts. Other large statutory appropriations of general fund in the 2007 biennium include:

- \$35.8 million of transfers to retirement funds (Title 19, MCA)
- \$36.5 million to service the debt on bonding issues approved by past legislatures (17-7-502, MCA)
- \$12.1 million of coal trust interest (that is deposited to the general fund) to fund economic development programs (15-35-108, MCA)

**LFD
Issue**
County Entitlement Payments

As stated above, \$173 million of general fund is projected to be spent in the 2007 biennium through statutory appropriations for entitlement payments to counties and tax increment financing districts. By statute, subsequent yearly amounts are automatically increased by a calculated growth factor. Because the money is appropriated in statute, it is not reviewed by the legislature as part of the biennial budgeting process. In essence, it and all other general fund statutory appropriations have priority funding over all general fund programs appropriated in the general appropriations act (HB 2). In times when the legislature must prioritize general fund programs to balance the budget, programs funded with general fund statutory appropriations should be considered by the legislature along with all other general fund programs.

As an alternative to funding counties and tax increment financing districts entitlement payments through statutory appropriations, the legislature could eliminate the statutory appropriations and provide appropriations for the program in HB 2. This would ensure that the program and the appropriations are reviewed and prioritized along with the other general fund programs in HB 2 each biennium, and that the level of funding reflects the current legislature's funding priorities.

Governor's Emergency Appropriation

Although the legislature has authorized the Governor's Office to spend up to \$16.5 million general fund in a biennium whenever emergencies or disasters are declared by the Governor (10-3-312, MCA), the executive budget does not include any anticipated expenditures from this statutory appropriation. In the past, the legislature also has not budgeted for expenditures from this authorization. Even though emergencies and disasters are difficult to predict, prudent budgeting requires that a portion of general fund be reserved for this contingency. Governor directed spending reductions or special legislative sessions may be required if events cause the expenditure of the entire \$16.5 million and nothing has been budgeted. The general fund balance projected by the Legislative Fiscal Division includes a \$14.9 million general fund reserve in each year of the 2007 biennium.

**LFD
Comment**
Executive Proposals

The Department of Justice is proposing legislation to create three new general fund statutory appropriations to make payments mandated in statute. HB 559, enacted by the 2003 legislature earmarked certain vehicle fees, which are deposited to the general fund, to be paid to the highway patrol retirement fund (MCA: 61-3-527, 61-3-530, and 61-3-562). The estimated general fund impact is \$199,000 in the 2007 biennium. Because these fiscal impacts require passage of legislation, they are not included in the Legislative Fiscal Division's general fund balance.

Rather than creating three new statutory appropriations of general fund, the legislature could appropriate the general fund for this purpose in HB 2.

Figure 22

General Fund Statutory Appropriation Estimates
Fiscal Years 2005-2007
(in millions)

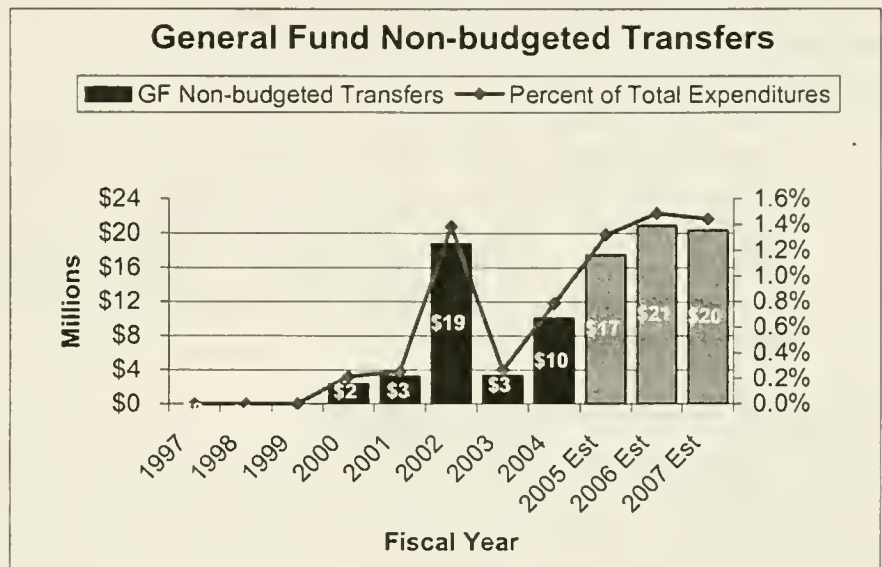
MCA Cite	Name	Fiscal 2005	2007 Biennium		
			Fiscal 2006	Fiscal 2007	Total
<u>Retirement</u>					
19-13-604	Prem Tax-Fire/Pol 19-13-604-SA	\$6.857	\$7.198	\$7.556	\$14.754
19-17-301	Prem Tax-Fire/Pol 19-17-301-SA	1.563	1.704	1.857	3.561
19-18-512(1)	Prem Tax-Fire/Pol 19-18-512-SA	0.245	0.250	0.265	0.515
19-19-305(1)	Prem Tax-Fire/Pol 19-19-305-SA	0.250	0.250	0.250	0.500
19-19-506(4)	Prem Tax-Fire/Pol 19-19-506-SA	0.021	0.021	0.021	0.041
19-9-702	Ins Prem Tax-Fire/Pol Ret 19-9-702-SA	<u>7.591</u>	<u>7.995</u>	<u>8.419</u>	<u>16.414</u>
Sub-total		\$16.527	\$17.417	\$18.368	\$35.784
<u>Economic Development</u>					
15-35-108(7)(b)(i)	Coop Developmental Center NMC	\$0.065	\$0.065	\$0.065	\$0.130
15-35-108(7)(b)(ii)	Add Vision 2005-SA	1.250	1.250	1.250	2.500
15-35-108(7)(b)(iii)	Research & Commercialization	0.000	3.650	3.650	7.300
15-35-108(7)(b)(iii&iv)	Economic Development	1.100	1.100	1.100	2.200
15-35-108(7)(b)(iv)	Reimbursement of TIFF-SA	<u>0.600</u>	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>
Sub-total		\$3.015	\$6.065	\$6.065	\$12.130
<u>Other</u>					
10-3-312(1)	Emergency Appropriations	\$0.020	\$0.000	\$0.000	\$0.000
15-1-111(6)	Local Asst-Prop Red PA-SA	4.865	3.613	2.408	6.021
15-1-121(3)	HB124 Combined Distribution - SA	81.331	83.711	86.292	170.003
15-1-121(6)	HB124 TIFF Distribution - SA	3.608	1.475	1.475	2.950
17-3-106(2)	Cash Management Interest-SA	0.009	0.009	0.009	0.019
17-6-101(6)	Banking Charges-SA	1.241	1.266	1.293	2.559
17-7-502(4)	TRANS Debt Service and Issuance Costs	0.000	0.000	0.000	0.000
17-7-502(4)	Transfer to Debt Service A/B Bond-SA	16.941	18.395	18.524	36.918
19-20-604	Teachers GABA 19-20-604-SA	0.685	0.699	0.720	1.419
19-3-319	Local Government PERD 19-3-319 -SA	<u>0.418</u>	<u>0.435</u>	<u>0.452</u>	<u>0.887</u>
Sub-total		\$109.119	\$109.604	\$111.173	\$220.777
Total		\$128.661	\$133.085	\$135.606	\$268.691

GENERAL FUND NON-BUDGETED TRANSFERS

The Montana Constitution requires that all money paid out of the state treasury, except interest paid on the public debt, be done with an appropriation. However, the state treasury consists of numerous accounts and, with proper authorization, money may be transferred from one account to another without an appropriation. This results in less money in one account for the programs it funds and more in another. Like statutory appropriations, these transfers and their authorizations are in statute and are not part of the biennial budgeting process, yet they affect the amount of money available for the legislature to appropriate for specific programs. Because they are in statute, they remain in place until removed or changed by legislation.

Since FY 2000, increased amounts of money have been transferred out of the general fund to other accounts that fund non-general fund programs. As illustrated in Figure 23, this amount has grown from \$0 in FY 1999 to \$19 million in FY 2002 (about 1.4 percent of total general fund expenditures), and transfers are estimated to be over \$41 million in the 2007 biennium. These transfers reduce the amount of money in the general fund that is available for general fund programs and increase the amount available for other non-

Figure 23



general fund programs. Figure 24 shows each non-budgeted general fund transfer that has been included in the general fund balance sheet.

LFD ISSUE

MCA Title 15 Transfers

The largest group of transfers out of the general fund is the transfer of multiple vehicle and other fees that are initially deposited to the general fund (15-1-122, MCA). These fees are then earmarked and transferred out to multiple accounts to fund various state programs. The practice of transferring money out of the general fund escalated sharply with the enactment of HB 124 (entitlement payments to counties) in the 2001 session and the amount transferred has increased each biennium since. The practice is not conducive to good budgeting and unnecessarily complicates the revenue and disbursement processes. The legislature could eliminate this complicated and unnecessary practice and achieve the same results by implementing one of the following:

1. Earmark the applicable fees and provide for their direct deposit to the various program accounts. This bypasses the unnecessary step of first depositing the money in the general fund and then transferring the general fund to the various program accounts. Since the money is already being appropriated from these program accounts, current appropriations would not change.



2. Continue to deposit the applicable fees to the general fund, but eliminate the transfers to the various program accounts. Since there would be no transfer revenue to appropriate from the various program accounts, appropriations from these accounts would be eliminated and replaced by general fund appropriations in the same amounts.

In both cases, the various state programs receive the same level of appropriation and the general fund transfers are eliminated.

U.S. Mineral Royalty Transfer

The next largest transfer, \$17.5 million in the 2007 biennium, involves U.S. mineral royalty revenue deposited in the general fund. Statute directs all the revenue to the general fund, but requires 25 percent of the amount to be transferred to the mineral impact state special revenue account. Money in this account is statutorily appropriated to eligible counties in which the minerals were extracted. Since the amount of U.S. royalties that the state receives has increased substantially since FY 2002 when the transfer first became effective, the amounts transferred have also increased. The legislature could eliminate this unnecessary practice and achieve the same result by implementing one of the following:

1. Deposit 25 percent of U.S. mineral royalty revenue directly to the mineral impact account and eliminate the unnecessary step of first depositing the money in the general fund.
2. Continue to deposit all U.S. mineral royalty revenue to the general fund, but eliminate the transfer and the mineral impact account. Statutorily appropriate general fund in an amount equal to 25 percent of the U.S. mineral royalty revenue deposited to the general fund directly to eligible counties.

Primary Business Workforce Training

Figure 24 shows no transfers from 39-11-203, MCA. HB 564 (enacted by the 2003 legislature) created the Primary Business Workforce Training Program, with the authorization to borrow up to \$10 million for use as grants from the Board of Investments INTERCAP loan program. Loan repayments are calculated on the number of new jobs created. Additional individual income tax revenue deposited in the general fund as a result of these jobs is transferred from the general fund to the Office of Economic Development: 1) 95 percent to repay interest and principal on the loan; and 2) 5 percent to assist the Department of Labor and Industry in reporting and analyzing data. Because there is some question on whether INTERCAP loans constitute state debt (a 2/3 vote was not required for the passage of HB 564), the Board of Investments will not provide funding for these loans until the legislature addresses the issue.



Executive Proposals

The Revenue and Transportation Interim Committee is sponsoring legislation at the request of the Department of Revenue to correct oversights that occurred in the 2003 session that prevented the transfer of certain vehicle fee revenue from the general fund.

An oversight with the enactment of HB 559 resulted in the elimination of certain transfers of general fund vehicle fee revenue to the departments of Fish, Wildlife and Parks and Agriculture in the 2005 biennium. The proposed legislation is retroactive to January 1, 2005 and will reinstate the transfers for fiscal 2005. The general fund fiscal impact in fiscal 2005 is estimated to be \$851,000.

LFD
Comment Cont.

SB 112, enacted by the 2003 legislature, imposed a new search and rescue fee on certain vehicles. Although the fee revenue is deposited to the general fund, a coordination oversight prevents the general fund revenue from being transferred to the state special revenue account. The legislation retroactively corrects this oversight. The estimated fiscal impact to the general fund is \$417,600 in FY 2005 and \$284,900 in the 2007 biennium. Because these fiscal impacts require passage of legislation, they are not included in the Legislative Fiscal Division's general fund balance.

Figure 24
General Fund Non-budgeted Transfer Estimates
Fiscal Years 2005-2007
(millions)

Authorization	Name	Fiscal 2005	2007 Biennium		
			Fiscal 2006	Fiscal 2007	Total
<u>MCA Title 15 Transfers</u>					
15-1-122(1)	Adoption services	\$0.044	\$0.049	\$0.054	\$0.103
15-1-122(2)(c,d)	To the Department of Transportation	0.000	3.050	3.096	6.146
15-1-122(3)(a)(i)	Junk vehicle titling fee	0.740	0.776	0.646	1.422
15-1-122(3)(a)(ii)	Junk vehicle registration fee	1.044	1.085	1.110	2.195
15-1-122(3)(b)(i)	Weed fee OHV FILT	0.000	0.033	0.031	0.064
15-1-122(3)(b)(ii)(A)	Weed Vehicle <1 ton, logging, motor home	1.535	1.596	1.635	3.232
15-1-122(3)(b)(ii)(B)	Weed motorcycles & quadracycles	0.000	0.070	0.050	0.119
15-1-122(3)(b)(ii)(C)	Weed Vehicle permanent	0.062	0.064	0.066	0.130
15-1-122(3)(c)(i)	Watercraft decal fee	0.000	0.141	0.132	0.272
15-1-122(3)(c)(ii&iii)	Snowmobile decal fees	0.000	0.140	0.122	0.262
15-1-122(3)(c)(iv)	OHV decal fees	0.000	0.164	0.154	0.318
15-1-122(3)(c)(v)	Parks recreational fee	0.000	0.237	0.267	0.504
15-1-122(3)(c)(vi)	Watercraft FILT 20%	0.272	0.571	0.184	0.755
15-1-122(3)(c)(vii)	Vehicle registration fee for parks	0.000	2.744	2.810	5.554
15-1-122(3)(d)	Veterans license plates	0.176	0.183	0.188	0.371
15-1-122(3)(e)(i)	Highway patrol retirement	0.000	0.000	0.000	0.000
15-1-122(3)(f)	DOT senior transportation	0.340	0.674	0.358	1.032
15-1-122(3)(g)	Search & rescue surcharge	0.000	0.000	0.000	0.000
15-1-122(3)(h)	Vehicle registration fee for veterans	<u>0.646</u>	<u>0.676</u>	<u>0.577</u>	<u>1.253</u>
Sub-total		\$4.860	\$12.252	\$11.480	\$23.732
<u>Other Transfers</u>					
15-35-108	Research & commercialization	\$3.650	\$0.000	\$0.000	0.000
17-3-240	To the mineral impact account	8.959	8.665	8.834	17.499
39-11-203(5)	Loan costs for job credits *	0.000	0.000	0.000	0.000
39-71-2352(6)	Old state fund shortfall	Unknown	Unknown	Unknown	Unknown
53-20-171(2)	Development disability tax credit	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
Subtotal		\$12.609	\$8.665	\$8.834	\$17.499
Total		\$17.470	\$20.917	\$20.314	\$41.231

* The Board of Investments will not provide funding for the loans until the issue of state debt is addressed by the legislature.

FUND BALANCE ADEQUACY/RESERVES

The severe revenue shortfalls that began in FY 2002 and continued into FY 2004 have been overtaken by a period of surging state revenues. This is apparent in revenue projections adopted by the Revenue and Transportation Interim Committee and in the sizable ending fund balance projected in the executive budget. However, there is no shortage of potential spending proposals, with school funding solutions at the top of most lists. In addition, much of the projected balance can be characterized as "one-time" revenues that, in theory, should not be spent on ongoing programs. The legislature needs to be aware of the tenuous nature of the surplus and keep in mind the need to maintain an adequate reserve.

Attaining general fund budget stability means more than setting appropriations equal to anticipated revenues, with a positive ending fund balance serving as a safety net. The adequacy of the state general fund balance can signify the difference between whether or not the state is forced to confront the unpleasant consequences of fiscal instability.

Montanans are all too familiar with the consequences of general fund balance inadequacy. In the late 1980's and early 1990's, the state general fund experienced a chronic deficit between revenues and disbursements. Much of the growth in the disbursement rate is a result of natural growth in expenditures due to inflation and/or caseload and enrollment increases, as well as supplemental spending for such contingencies as fire suppression. Revenue growth in the state has not always kept pace with expenditure growth. During the recent 2003 biennium, actual revenue growth was well below forecasts, primarily because of reduced income tax collection and lower interest rates, largely due to circumstances that could not be predicted when the 2003 biennium budget was being approved.

The Fifty-seventh Legislature adjourned from the 2001 regular session with a projected 2003 biennium general fund ending balance of \$54 million (2.3 percent of biennial appropriations). By the end of the first fiscal year, revenue collections for the biennium were \$153 million below legislative estimates. Even after Governor directed statutory spending reductions of \$23 million, a special session was necessary to achieve an acceptable ending fund balance reserve through an additional \$59 million in budget balancing actions. Revenues still remained unstable as the Fifty-eighth Legislature imposed additional reductions as it shaped the 2005 biennium budget, ending the session with a projected fund balance of \$46.2 million or 1.7 percent. As we are now aware, revenue collections are running well ahead of estimates, and the 2005 legislature faces a nearly unprecedented "surplus" as it prepares to craft the 2007 biennium budget.

Recognizing that budgetary imbalances and revenue swings can occur, the state can either take a reactive or a proactive approach. During the 1993 and 1995 biennia, the state held three special legislative sessions to deal with budget shortfalls. Another occurred in August of 2002. Although special sessions allow lawmakers the ability to address issues relative to revenues and expenditures, special sessions can cost the taxpayers approximately \$50,000 per day. The need for special sessions is also closely scrutinized by the national agencies that rate the state's debt. Rating agencies also use a state's general fund balance as a percent of revenues as one of the key financial indicators for credit analysis.

Again from a reactive stance, budgetary fluctuation can be temporarily resolved through spending reductions. In accordance with 17-7-140, MCA, the Governor can authorize spending reductions: "...in an amount that ensures that the projected ending general fund balance for the biennium will be at least

1 percent of all general fund appropriations during the biennium.” Essentially, the executive branch assumes control of the budget decision-making process by implementing and prioritizing spending reductions. Further, budgetary imbalances can be addressed only from one side of the equation -- expenditures. This means that legislative priorities could potentially get lost in the process.

Because of the cost and disadvantages of taking a reactive approach to budget imbalances, a more effective method may be to approach these issues proactively through provision of adequate fund balance reserves. National fiscal experts such as the National Conference of State Legislatures (NCSL) recommend a reserve fund balance of 3 to 5 percent of total appropriations or revenues. Because Montana’s budget is implemented on a biennial basis -- resulting in considerably more risk than an annual budgeting process -- the 3 to 5 percent should be applied to biennial totals. For Montana, with projected total general fund revenues of \$2.9 billion, a minimum 3 percent reserve equates to an \$87.0 million ending fund balance. The revenue volatility of recent years might suggest that an even higher reserve would be more prudent. The executive budget balance sheet shows an ending fund balance of approximately \$162.9 million, or 5.7 percent. However, the executive document recommends a fund balance of \$80 million, or 2.8 percent, recognizing that school funding and other unresolved issues may utilize part of the existing reserve.

The provision of an adequate general fund balance is essential to achieving a sound financial foundation. The level of fund balance reserves must be sufficient to offset the volatility of revenues and the potential for unforeseen expenditure increases. It is even more important since Montana is one of only three states that do not have a rainy day fund provision (although the legislature is expected to consider one or more “rainy day fund” bills this session). To this end, the legislature will again need to determine what amount of ending fund balance is sufficient to ensure budget stability.

The Legislative Finance Committee has submitted a committee bill to establish a “rainy day fund”, and several other bill drafts have been requested to establish such a fund. This is another tool to ensure fund stability, and would impact the decision as to what constitutes an adequate fund balance reserve. The opportunity to establish such a fund is enhanced by the current surplus, which provides an opportunity to put “seed money” in the fund. However, the placement of funds in such a fund will have to compete with other spending priority options that will be requested in the 2005 session.

OTHER MAJOR FUNDS

HIGHWAYS STATE SPECIAL REVENUE ACCOUNT DECLINING WORKING CAPITAL BALANCE

The 2005 Legislature is faced with a declining working capital balance in the highways state special revenue account. The account is projected to end FY 2007 with a working capital balance of \$19.1 million, which is down from a \$39.1 million balance at the end of FY 2004. Projections indicate that expenditures will exceed revenues by \$19.0 million in the 2007 biennium, with the imbalance continuing in future biennia.

Revenues to the account, which are from highway users fees primarily comprised of motor fuel tax collections and gross vehicle weight fees, are expected to increase at an average annual growth rate of 1.9 percent from FY 2005 through FY 2007. Revenue growth is not expected to keep pace with rising expenditure levels and inflationary increases associated with highway construction and related programs.

The inability of the U.S. Congress to pass long-term federal highway funding legislation provides uncertainty in the level of federal-aid funding for highways and impacts state matching funds of the account. The potential exists that higher levels of federal-aid for highways would be received and matching requirements of state funds would increase correspondingly. Although the account is not expected to feel the impact of increased federal funding immediately, increased state match requirements would add to future account instability. The inelasticity of program revenues has contributed to the chronic deficit spending imbalance of this program.

Deficit spending is a key contributor to the projected decline in working capital balance. Without actions to bring revenue and expenditure growth rates more in line with each other, the account is projected to continue to decline and could begin to impact the ability of the Department of Transportation to provide for the needs of the state highway infrastructure.

This issue is presented in more detail in the Department of Transportation budget discussion in Volume 3, General Government and Transportation Section; page A-100.

RESOURCE INDEMNITY TRUST (RIT)

The following is a brief summary of the Resource Indemnity Trust account and related issues. For detailed information on the Resource Indemnity Trust, please see the agency summary section of the Department of Natural Resources and Conservation in Volume 4, of the Legislative Budget Analysis, page C-114.

Article IX of the Montana Constitution provides for the protection and improvement of the Montana environment and requests that the legislature provide adequate remedies for environmental protection from degradation. The Constitution specifically requires “all lands disturbed by the taking of natural resources shall be reclaimed”, and requires the existence of a resource indemnity trust (RIT) fund for that purpose, to be funded by taxes on the extraction of natural resources.

The Constitution further states, “The principal of the resource indemnity trust shall forever remain inviolate in an amount of one hundred million dollars (\$100,000,000) guaranteed by the state against loss or diversion.”

The state constitution requires a trust, but does not require the trust to be funded. The legislature utilized certain natural resource extraction tax proceeds as a revenue source for the trust. In February of 2002, the Governor certified the balance of the trust had exceeded the \$100 million threshold. Consequently, the trust no longer receives revenue and those tax proceeds previously directed to the RIT were re-directed by the 2003 legislature.

Accounts and Related Actual, Budgeted and Proposed Expenditures

Figure 25 (2007 RIT) represents the four elements of the Resource Indemnity Trust and related taxes as defined by current statute. Each element has been shown to provide a breakdown of interest earnings and allocations.

Resource Indemnity Trust (RIT)

Section one shows the RIT estimated revenues and balances as provided by the Revenue and Transportation Interim Committee (RTIC) for FY 2005, FY 2006, and FY 2007. As of fiscal year end 2004, the RIT trust had a balance of \$100,002,390. The projected ending balance for FY 2005 is estimated at \$100,254,844 as a result of a \$252,454 transfer from the groundwater assessment fund, which had exceeded the statutory limit.

LFD ISSUE

Since the RIT balance is in excess of the constitutionally required \$100 million, excess trust balance is available for appropriation.

RIGWA/Oil & Gas

Section two provides the revenue estimates and details the statutory allocations of the resource indemnity ground water assessment (RIGWA) and applicable portions of the oil and gas tax. The allocations for RIGWA are as dictated in statute. The natural resource worker scholarship account has a maximum balance of \$150,000. Allocations to the account are based upon the amount needed to bring the account to the \$150,000 balance, which in FY 2005 was \$93,508. The applicable portions of the oil and gas tax are delivered to the funds on a percentage basis.

Interest

Section three provides the amount of interest generated by the RIT and the amounts that are allocated by statute for a specific purpose, 15-38-202, MCA. For the 2007 biennium, statute allocates \$9.8 million in interest for eight purposes.

Based upon FY 2005 expenditures, the environmental contingency account may not receive the total disbursement of \$175,000, as the fund is approaching the maximum balance of \$750,000.

Two changes in allocations occur for this biennium: 1) Future Fisheries receives an additional \$150,000 per fiscal year, bringing the annual allocation to \$500,000; and 2) the annual allocation for reclamation and development grants is increased from \$1.2 million per year to \$1.5 million per year.

After allocations are made, the amount available for further distribution by formula is \$2.1 million in FY 2006 and \$2.9 million in FY 2007, or \$5.0 million for the biennium. The amount available for further distribution in the 2007 biennium is \$1.1 million less than the \$6.0 million available in the 2005 biennium. This change is not due to interest earnings but rather to the changes in allocation that occur in the 2007 biennium.

Expenditure Accounts

Section four provides a breakdown of the related expenditure accounts. The table displays current fund balances, adjustments for revenues and executive appropriations, and the projected 2007 biennium ending balance. The executive appropriations section provides detail of program and department appropriations contained in the executive budget.

Fund balance shortfalls

Two funds are expected to have a negative balance at the end of the biennium. The hazardous waste/CERCLA fund will receive \$1.3 million in revenues in the 2007 biennium, but \$1.4 million in appropriations are included in the executive budget. The projected 2007 fiscal year end fund balance is negative \$0.2 million. Legislation passed in the 2003 session allowed up to \$600,000 to be transferred from the orphan share to the hazardous waste/CERCLA fund, but must be returned when the fund balance increases. A \$200,000 transfer was made. The orphan share has a projected FY 2007 ending balance of \$6.3 million. However, the legislation providing transfer authority expires at the end of the 2005 biennium.

The environmental quality protection fund will receive \$1.5 million in revenues in the 2007 biennium, but \$2.2 million in appropriations are included in the executive budget. The projected 2007 fiscal year end fund balance is negative \$80,000. This balance could change if the amount of cost recovery is greater than estimated.

The renewable resource fund ends the biennium with a positive cash balance. In previous biennia the library commission received \$0.4 million and the conservation and resource development division of DNRC received \$0.6 million from the renewable resource fund. Funding for these activities has been diverted to the reclamation and development fund. Without this diversion, the renewable resource fund would have ended the 2007 biennium with a negative balance of \$0.8 million.

**LFD
ISSUE**

There are two issues with RIT funding: 1) Statute regarding the renewable resource account and the reclamation and development account does not support the use of funds for non-program related activities; and 2) lack of overall oversight puts the stability of any one of the funds at risk.

Statutory Uses

According to 85-1-604, MCA, the renewable resource account is established for the renewable resource grant and loan program. Appropriations from the account are limited to grants and administrative costs of the grant and loan program. Figure 25 illustrates the proposed executive appropriations from the fund. The executive is proposing to fund the Water Court with \$1.5 million in renewable resources funds over the 2007 biennium. The functions of the Water Court are not related to the grant and loan program. A similar situation exists with the reclamation and development account. According to 90-2-1104, MCA, appropriations can be made for grants and the administrative costs of the grant program. The executive budget includes \$0.8 million for the natural resource information system through the Library Commission. The NRIS is not directly related to the grant program. The legislature may wish to do one of the following:

1. Adjust statute to allow expenditure for other purposes
2. Replace funding for all functions except those authorized by statute

Lack of Oversight

The resource indemnity trust interest, the resource indemnity ground water assessment tax, the metaliferous mine tax, and applicable portions of the oil and gas tax will provide \$26.6 million in revenues over the 2007 biennium to the related resource accounts. Local governments, two universalities and four state agencies rely on these resources to operate programs, repair water projects, and maintain data systems. However, there is no centralized legislative oversight of the accounts when appropriations decisions are made. RIT appropriations are made in three separate subcommittees, and other bills impacting the RIT generally do not go through subcommittee process. The lack of general appropriations oversight of these related accounts put at risk the stability of any one of the funds, as illustrated by two examples.

1. The executive budget contains a funding switch of \$1.0 million between the reclamation and development and the renewable resource accounts. The funding switch is made not for programmatic reasons, but because the fund balance in one account was not sufficient to fund all functions, and a sufficient fund balance exists in the other. (None of the activities in question are related to the administration of the grant and loan programs – see the first issue)
2. Legislation will be introduced to increase the flexibility of the orphan share account. The legislation also grants the ability to move \$600,000 in funds from the orphan share account to the hazardous waste/CERCLA account and the environmental quality protection fund. Both funds are predicted to have a negative balance at the end of the biennium. While this action could bring the accounts to a positive position, it does not address the issue of why the transfer is needed, or what an appropriate balance is in the orphan share account

The legislature may wish to consider the following options:

1. Establish a process by which one legislative entity can examine all HB 2 and other proposed legislation impacting one or more RIT accounts during the legislative session to establish an overall policy for the 2007 biennium
2. Request that a study be conducted during the interim of the RIT accounts, including sources, uses, and long-term policy, for the purpose of making recommendations to the 2007 Legislature

**Resource Indemnity Trust (RIT): Interest Earnings, and Related Expenditure Accounts
2007 Biennium Projections (Including Executive Proposals and Appropriation Requests)**

1

RIT Revenues (RATC estimates)	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>
Projected Beginning Balance FY 2005		\$100,002,390	\$100,254,844	\$100,254,844
Fund Balance Allocations/transfers				
Transfer from Groundwater Assessment (02289)		\$252,454		
Total Deposits/Legislative Changes		\$252,454		
RIT Trust Balance	<u>\$100,002,390</u>	<u>\$100,254,844</u>	<u>\$100,254,844</u>	<u>\$100,254,844</u>

2

	<u>Fiscal 2005</u>	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>	<u>Biennium Total</u>
RIGWA Tax	\$1,229,000	\$1,176,000	\$1,323,000	\$2,499,000
<u>Statutory Allocations -- RIGWA</u>				
CERCLA Bonds Debt Service	\$0	\$160,000	\$320,000	480,000
Groundwater Assessment Account-direct (02289)	113,546	366,000	366,000	732,000
Reclamation & Development-50% of Remainder (02458)	431,500	318,000	312,000	630,000
Natural Resource Worker Scholarship * (2069)	93,508	13,508	13,508	27,016
Orphan Share Account- Remainder of RIGWA (02472)	<u>337,992</u>	<u>318,492</u>	<u>311,492</u>	<u>629,984</u>
TOTAL RIGWA STATUTORY ALLOCATIONS	<u>\$1,229,000</u>	<u>1,176,000</u>	<u>1,323,000</u>	<u>2,499,000</u>
Applicable Oil and Gas Tax	\$4,600,384	\$4,623,434	\$4,667,950	\$9,291,384
<u>Applicable Portion of Oil and Gas</u>				
Coal Bed Methane Protection - (02694) 1.23%	793,616	797,592	805,210	1,602,802
Reclamation & Development-(02458) 2.95%	1,903,384	1,912,921	1,931,190	3,844,111
Orphan Share Account - (02472) 2.95%	1,903,384	1,912,921	1,931,190	3,844,111
TOTAL Oil and Gas STATUTORY ALLOCATIONS	<u>4,600,384</u>	<u>4,623,434</u>	<u>4,667,590</u>	<u>9,291,024</u>

3

	<u>Fiscal 2005</u>	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>	<u>Biennium Total</u>
RIT Interest Earnings (RATC estimates)	\$7,401,000	\$7,417,000	\$7,420,000	\$14,837,000
Priority Statutory Allocations of Interest				
Environmental Contingency Account (02107)**	0	(175,000)	0	(175,000)
Oil & Gas Prod. Damage Mitigation Account (02010)***	0	(50,000)	0	(50,000)
Water Storage Account (02216)	0	(500,000)	0	(500,000)
Groundwater Assessment Account-direct (02289) ****	(300,000)	(300,000)	(300,000)	(600,000)
MSU-Northern Statutory Appropriation (02272)	(240,000)	(240,000)	(240,000)	(480,000)
Fish, Wildlife, and Parks -- Future Fisheries (02022)	(350,000)	(500,000)	(500,000)	(1,000,000)
Renewable Resource Grant & Loan Program (02272)	(2,000,000)	(2,000,000)	(2,000,000)	(4,000,000)
Reclamation & Development Grants (grants) (02458)	<u>(1,200,000)</u>	<u>(1,500,000)</u>	<u>(1,500,000)</u>	<u>(3,000,000)</u>
Total Allocations	(\$4,090,000)	(\$5,265,000)	(\$4,540,000)	(\$9,805,000)
Amount Available for Further Distribution	<u>\$3,311,000</u>	<u>\$2,152,000</u>	<u>\$2,880,000</u>	<u>\$5,032,000</u>

Figure 25

4

Related Expenditure Accounts (2007 biennium totals)	Renewable Resource (02272)	Reclamation & Development (02458)	Haz. Waste CERCLA (02070)	Environmental Quality Protect. (02162)	Groundwater Assessment (02289)****	Water Storage (02216)	Orphan Share (02472)
Further Distribution % of RIT Interest	30.0%	35%	26%	9.0%	0%	0%	0%
Beginning Fiscal 2005 Fund Balance (\$ABHRS)	\$1,396,368	\$1,944,494	\$194,540	\$839,661	\$252,454	\$320,696	\$5,093,800
Continuing appropriations	(3,882,647)	(2,580,217)	(31,231)			(589,979)	0
Fiscal 2005 appropriations	(979,066)	(2,961,720)	(895,656)	(915,792)	(666,000)	0	(1,350,144)
Fiscal 2005 Adjustments	0	0	0	0	(252,454)	0	0
Fiscal 2005 revenues (RTIC, agency estimates)	<u>3,930,782</u>	<u>5,565,834</u>	<u>582,000</u>	<u>712,900</u>	<u>666,000</u>	<u>138,000</u>	<u>2,254,000</u>
Projected Available Fund Balance Beginning FY2006	\$465,437	\$1,968,391	(\$150,347)	\$636,769	\$0	(\$131,283)	\$5,997,656
Revenues (RATC, agency estimates)							
RIT Interest-direct	\$4,480,000	\$3,000,000			\$600,000	\$500,000	
RIT Interest-further allocation by above %	1,509,600	1,761,200	1,308,320	452,880			
RIGWA Proceeds		4,474,111			732,000		4,474,095
Metal Mines Tax (7%)		1,311,000					
Coal Tax & Interest (from 04011)	516,009						
STIP/Other Interest	20,000		4,000	6,000		37,500	70,000
Cost Recoveries				1,023,800			
Transfers							
Administrative Fees	14,000						
State-owned Project Revenue	-	-	-	-	-	240,000	-
Total Revenues	<u>\$6,539,609</u>	<u>\$10,546,311</u>	<u>\$1,312,320</u>	<u>\$1,482,680</u>	<u>\$1,332,000</u>	<u>\$777,500</u>	<u>\$4,544,095</u>
Executive Appropriations							
House Bills 6 and 7 Grants (Executive Recommended)	\$4,000,000	\$3,000,000					
House Bill 6-Emergency/Private Grants (Recommended)							
MSU-Northern (statutorily appropriated)	480,000						
UM-Bureau of Mines					\$1,332,000		
DNRC - Centralized Services	10,000	12,000					
DNRC-Cooservation and Resource Devel. Division		1,630,243					
DNRC-Water Resources Division		107,428				544,600	
DEQ-Central Management		88,378	28,964				
DEQ-Planning, Prevention & Assistance			266,244				
DEQ-Enforcement		9,648					
DEQ-Remediation			47916	2,199,144			4,150,019
DEQ-Permitting & Compliance		3,243,521	1052358				
DNRCFlathead Basin Commission	16,002						
Judiciary-Water Court	1,533,510						
Library Commission-State Library Operations/NRIS		782,872					
House Bill 13 (executive pay plan estimate)	-	-	-	-	-	-	-
Total Appropriations	<u>\$6,039,512</u>	<u>\$8,874,090</u>	<u>\$1,395,482</u>	<u>\$2,199,144</u>	<u>\$1,332,000</u>	<u>\$544,600</u>	<u>\$4,150,019</u>
Projected 2007 Biennium Ending Balance	<u>\$965,534</u>	<u>\$3,640,612</u>	<u>(\$233,509)</u>	<u>(\$79,695)</u>	<u>\$0</u>	<u>\$101,617</u>	<u>\$6,391,732</u>

* Amounts are deposited to the Natural Resource Worker Scholarship to bring the balance up to \$150,000

** The governor must report on the expenditures from the environmental contingency account in the executive budget. Expenditures are statutorily appropriated.

*** Amounts are deposited to the oil & gas production damage mitigation account to bring the balance up to \$200,000 (82-11-161,MCA). All money in the account is statutorily appropriated.

**** Amounts are deposited to the groundwater assessment account to bring the balance up to \$666,000.

Figure 25
Continued

GENERAL REFERENCE

Budget Basics

Agency Comparisons by Fund

Trust Funds





BUDGET BASICS

BUDGET PROCESS – A PRIMER

PURPOSE

This section provides an overview of the basic budget concepts, definitions of budget terms, and background and reference information pertinent to the 2007 biennium budget and legislative appropriations process. For more in-depth information, see “Understanding State Finances and the Budgeting Process”, available through the Legislative Fiscal Division.

TYPES OF LEGISLATIVE APPROPRIATIONS

Article VIII, Section 14, of the Montana Constitution reads:

“Prohibited Payments: Except for interest on the public debt, no money shall be paid out of the treasury unless upon an appropriation made by law and a warrant drawn by the proper officer in pursuance thereof.”

Appropriations power lies with the legislature. In 17-7-501, MCA, three types of appropriations fall within the meanings of “appropriation made by law” as used in Article VIII, Section 14, of the Montana Constitution.

Temporary appropriations – Most activities of state government are funded on a temporary basis, usually for two-year periods. Funding, therefore, must be reauthorized by each legislature. The main vehicle for the provision of temporary appropriations is HB 2 (the General Appropriations Act).

Statutory appropriations – Statutory appropriations are made directly in statute, and are automatically made until and unless the law is changed. Statutory appropriations are listed in 17-7-502, MCA.

Budget amendments – Various authorities (most often the Governor) can approve the addition of certain funds (primarily federal) during the interim if certain statutorily- defined conditions are met. General fund appropriations cannot be added without express legislative approval.

In limited cases, authorizations to expend funds can also be made through appropriation or under general laws and contracts. The great majority of state agency operations are funded through temporary appropriations.

FUND TYPES

Governmental accounting differs from private enterprise accounting in that funding is segregated and defined by the source and use of the funding. There are four main groups of funds in state government accounting.

1. Governmental funds consist of the following funds:

- General fund includes all financial resources except those that must be accounted for in another fund. The general fund collects most general taxes levied, including individual and corporate income tax, property tax, and investment income. Revenue from a number of other taxes is also deposited into the general fund.
- Special revenue funds consist primarily of two funds:
- State special revenue is money from state and other sources earmarked for the purpose of defraying particular costs of an agency, program, or function. The largest state special revenue accounts are the Highways State Special Revenue Account (HSSRA), which collects various fuel taxes and is used to support highway-related functions, and the general license account, which collects various hunting and fishing fees and is used to support functions in the Department of Fish, Wildlife, and Parks
- Federal special revenue is revenue from federal sources. Most state agencies receive some federal funds. The two major sources of federal funds are used to support highway-related functions and human services programs such as Medicaid. This fund also accounts for trust activity formerly defined as expendable trusts.
- Debt service funds are used to account for the accumulation of resources for the payment of general long-term obligations, including principal and interest. Debt service funds are statutorily appropriated.
- Capital projects funds are financial resources used for the acquisition or construction of major fixed assets. These funds are appropriated through bills that fund capital projects.
- Permanent funds account for resources that are restricted to the extent that only earnings and not principal may be expended for purposes that support state programs. These resources were formerly classified as non-expendable trusts (i.e. the coal tax trust).

2. Proprietary funds are used for operations that provide goods or services to the public on a user-charge basis (enterprise funds), or to other agencies or programs of state government (internal service funds).
3. Fiduciary funds provide for those assets held by state government in a trustee capacity, or as an agency for individuals, private organizations, other governmental entities, or other funds.
4. University funds are used to support the university system and are classified according to the College and University Business Association (CUBA) structure. The legislature appropriates a portion of the funds used to support the university system as governmental funds, which are then reclassified as university system funds.

With the exception of a small portion of proprietary funds, the legislature does not directly appropriate proprietary, fiduciary, or university funds. The legislature directly appropriates most governmental funds. Debt service funds are usually statutorily appropriated. Capital projects funds are appropriated in the bills that fund the capital projects. The great majority of general fund monies and special revenue funds are appropriated through temporary appropriations bills.

HB 2

The temporary spending bill through which almost 90 percent of general fund monies and special revenue funds are appropriated is HB 2, the General Appropriations Act. The budget analysis contained in Volumes 3 and 4 of the Legislative Fiscal Division 2005 Biennium Executive Budget Analysis concentrates on the appropriations proposed for inclusion in HB 2.

Statute requires that the legislature establish fees and charges for all internal services functions. Statute further restricts programs from increasing those fees and charges during the biennium. The Executive Budget must also include a rate analysis of enterprise funds and internal service fees and charges. While only a small portion of proprietary funds are appropriated in HB 2, all rates approved by the legislature are listed in that bill.

Figure 1 shows all internal services rates reviewed and approved by the legislature.

BUDGET TERMS

Budgets must, by statute, be submitted in three tiers to allow legislative scrutiny of all stages of budget development:

The base - defined as the resources for the operation of state government, and used to cover current biennium expenses of an ongoing and non-extraordinary nature. The base and how it is derived are discussed in more detail in the "Base Budget" portion of this narrative.

Present law - defined as that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature. Present law includes but is not limited to legally-mandated workload, caseload, or enrollment changes, changes in funding requirements, inflationary or deflationary adjustments, and elimination of one-time appropriations.

New proposals - defined as requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

Changes to the budget are made individually through decision packages, which must be approved by the legislature. Decision packages can either change present law or add new proposals approved for funding.

Figure 1

Internal Services Functions 2005 Biennium

Agency/Program or Function

Secretary of State
Records Management
Administrative Rules
Transportation
Motor Pool
Equipment
Revenue
Customer Service Center
Administration
Accounting/Management Support
Procurement and Printing
Information Services, including SA BHRS Operations
General Services
Mail and Distribution
Professional Development Center
Payroll
State Employee Benefits
Risk Management/Tort Defense
Fish, Wildlife, and Parks
Administration and Finance
Capitol Grounds Maintenance
Aircraft and Vehicle Usage
Duplicating and Bindery
Environmental Quality
Central Management
Natural Resources and Conservation
Air Operations
Commerce
Local Government Services
Board of Investments
Director/Management Services
Justice
Agency Legal Services
Corrections
Corrections Enterprises
Cook/Chill
Labor and Industry
Professional and Occupational Licensing
Central Services Division
Office of Public Instruction
Centralized Services
Advanced Drivers Education
Montana University System
MUS Group Insurance

SUBMISSION DATES

The director of the Office of Budget and Program Planning (OBPP) is required to submit a preliminary budget reflecting the base budget to the LFD by October 10, and a preliminary budget reflecting a present law base by November 1 in the year before a session. The director is further required to submit an entire preliminary budget by November 15. The LFD provides a detailed and comprehensive analysis of the executive budget, as well as an analysis of other fiscal policy issues.

BASE BUDGET

The current executive budget used actual fiscal 2004 expenditures as recorded on the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) as the base for determining a present law budget for the 2007 biennium. Certain items were then excluded in order to create a base that reflects only: 1) the cost of ongoing programs or functions approved by the last legislature; and 2) expenditures authorized by the legislature. OBPP and LFD staff reached agreement on virtually all expenditures removed from the base. The LFD analysis provides an explanation within context of any program in which a base difference remains.

Expenditure Base Exclusions

Following is an explanation of each type of expenditure category excluded from the base:

Appropriation Transfers

Section 17-7-301, MCA, allows the Governor to authorize the transfer of funds appropriated for the second year of the biennium to the first year, if the Governor finds that “due to an unforeseen or an unanticipated emergency” the amount appropriated for the first year of the biennium “will be insufficient for the operation and maintenance of the department.” Since such transfers do not result from legislative action and may be used for meeting one-time costs, these transfers are excluded from the base. However, if the transfer funds an ongoing cost, OBPP adjusts the present law budgets for the next biennium accordingly.

Budget Amendments

Budget amendments provide temporary authority allowing agencies to spend unanticipated non-general fund revenue received after the legislature has adjourned. This revenue can be used to provide additional services. In accordance with 17-7-402, MCA, budget amendment authority terminates at the end of each biennium and can make no “ascertainable present or future significant commitment for increased general fund support.” Expenditures financed through budget amendments are excluded from the base. If an agency wishes to continue an activity financed with a budget amendment in the following biennium, the request must be presented as a new proposal.

One-Time Appropriations

In general, miscellaneous or “cat and dog” appropriations (appropriations made in bills other than the general appropriations act) are considered “one-time” and not continued in the base. The legislature may specify in appropriation acts that an appropriation is not intended to be ongoing and may not be included in the base.

Language Appropriations

In appropriation acts, the legislature may authorize expenditure of funds from a specific source without

providing a specific dollar appropriation. Language appropriations are generally used when an agency knows that it will be receiving federal or state special revenue funds (that it is required by statute to spend) but is uncertain as to the amount of those funds. In order to be sanctioned by law as an appropriation, the language must, at least, fix a maximum amount that the appropriations may not exceed. Assuming that ongoing expenditures from these sources are one-time only in nature, the expenditures are excluded from the base.

Non-Budgeted Expenditures

Generally Accepted Accounting Principles (GAAP) require agencies to make accounting entries for depreciation, amortization, and other financial transactions that appear as expenditures, but don't result in the actual expenditure of funds from the state treasury.

Statutory Appropriations

Section 17-7-501, MCA, provides that funds may be appropriated in permanent law rather than through appropriation bills, which are effective for one biennium only. In order for a statutory appropriation to be valid, the statute creating the appropriation must specifically state that it is a statutory appropriation. The statute must then be listed in section 17-7-502, MCA. Currently, there are 72 valid statutory appropriation references listed. Examples of statutory appropriations include reimbursements to local governments and debt service payments.

Other Appropriations

This category includes administrative transfers created by OBPP, continuing appropriations from previous years, internal offset adjustments to appropriations, and miscellaneous appropriations.

ENTITLEMENT AND FORMULA FUNDED PROGRAMS

Under current state and federal law, certain programs are "entitlement programs," which means that if an individual meets the underlying criteria for qualification, services must be provided (i.e., the person is "entitled" to the service). Projected growth or declines in these programs are funded as part of the present law budget, rather than through new proposals. For example, the legislature has established statutory levels of state support for each child enrolled in Montana public schools. Similarly, federal and state laws require that persons eligible for Medicaid receive specified services or grants. Programs treated as entitlement include K-12 BASE aid, subsidized adoption, foster care, and Medicaid.

PERSONAL SERVICES "SNAPSHOT"

Personal services costs comprise over 39 percent of total agency operating expenditures (excluding capital outlay, grants and benefits, and transfers) in the 2007 biennium executive budget.

The executive budget is based on a "snapshot" of actual salaries for authorized FTE, as they existed in the last pay period of fiscal 2004. The executive budget includes annualization of the pay increases appropriated in fiscal 2004 and 2005.

Benefits are added on an individual FTE basis. Workers' Compensation and Unemployment Insurance rates vary from agency to agency, as each agency has a different rate based upon experience.

VACANCY SAVINGS

Vacancy savings is the difference between the full appropriated cost and the actual cost of authorized

employee positions during a budget period. Since 1979, the legislature has periodically applied a vacancy savings factor to agency budgets in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than the amounts appropriated.

During the 1997 biennium, the legislature included varying vacancy savings rates among selected agencies, and among programs within agencies, in order to fund the executive pay plan. A contingency fund containing \$500,000 general fund and \$1,000,000 in other funds was included for this purpose.

During the 1999 biennium, the legislature applied a uniform 3 percent vacancy savings rate against all positions in state government, with the exception of those positions in agencies with fewer than 20 FTE. The legislature also assumed that any new positions added via new proposals would not be hired at the very beginning of the fiscal year as a result of the need to recruit and to meet other requirements demanding the expenditure of time. Operating under the assumption that such positions would not be filled for the first three months of the fiscal year, the legislature applied a 25 percent vacancy savings rate in the first year. The legislature also provided \$2.3 million general fund and \$8.8 million in other funds for the biennium in support of a contingency pool for those agencies that could not meet their vacancy savings targets.

For the 2001 biennium, the legislature adopted a vacancy savings rate of 3 percent on all personal services except insurance. This rate was not applied to agencies with fewer than 20 FTE, elected officials, university system faculty or to direct care workers within the Department of Corrections. The legislature funded a contingency pool of \$700,000 from the general fund and \$950,000 in other funding for the biennium.

For the 2003 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. As in the 2001 biennium, agencies with fewer than 20 FTE as well as university system faculty were exempt. The legislature also included a contingency fund of \$1.3 million general fund and \$3.0 million from other funds (the legislative branch also received \$200,000 general fund) for the biennium to meet potential costs involved for those agencies that do not meet their vacancy savings targets.

For the 2005 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. As in the 2003 and 2005 biennia, agencies with fewer than 20 FTE as well as university system faculty are exempt. A contingency fund of \$1.5 million general fund and \$3.0 million other funds was added to fund potential costs in excess of the appropriation.

In the 2007 biennium, the executive is once again recommending a 4 percent vacancy savings on all personal services. The following agencies and positions were exempted:

- Agencies with fewer than 20 FTE
- University system faculty
- Elected officials
- Judiciary
- Legislative Branch

FIXED COSTS

Agencies are charged fees (called fixed costs) for a variety of services provided by other state agencies. The executive budget includes fixed costs for the following services: Department of Administration (DofA) insurance and bonds (62104), DofA warrant writing fees (62113), DofA payroll

service fees (62114), Legislative Auditor audit fees (62122), SABHRS (Statewide Accounting, Budgeting, and Human Resources System) operating costs (62148), DofA network fees (62174), messenger services (62307), state motor pool lease vehicle (62510), DofA rent (62527), capitol complex grounds maintenance (62770), and the statewide cost allocation plan (62888).

Figure 2 shows the total amounts included in the executive budget for fixed costs.

Insurance and Bonds

The Risk Management and Tort Defense Division of the DofA collects premiums from state agencies for: 1) administration of the self-insurance program, which provides state agencies with general liability and automobile coverage; and 2) purchase of commercial policies for state agency property, aircraft, and to protect against the potential consequences of other risks. Costs are allocated to agencies based upon actual loss experience and inherent exposure.

Figure 2		
Fixed Costs		
2007 Biennium Executive Budget (in millions)*		
Subcommittee/Agency	Function	Total
General Government		
Administration	Insurance and Bonds	\$28.9
	Warrant Writing Fees	1.6
	Payroll Service Fees	0.9
	Data Network Services	21.6
	SABHRS Operating	12.7
	Messenger Services	0.3
	Rent - Buildings	13.5
Legislative Audit Division	Audit Fees	3.1
Natural Resources and Commerce		
Fish, Wildlife, and Parks	Grounds Maintenance	0.7
Various	Statewide Cost Allocation	3.7
Total		<u>\$86.9</u>

Warrant Writing Fees

DofA provides warrant writing and direct deposit services for agency financial transactions. The costs of these services are allocated to agencies based upon actual utilization of the various types of transactions in the three previous years.

Payroll Service Fees

The State Payroll Program in DofA prepares and distributes payroll for all state agencies. Costs of these services are allocated to agencies based upon the number of paychecks issued for each agency per year.

Audit Fees

The legislative Audit Division charges agencies for the costs of financial compliance audits. These charges are included in agency budgets as biennial appropriations and allocated according to the estimated number of billable hours for each agency audit.

SABHRS Operations Unit

This unit provides all operational support for the Statewide Accounting, Budget, and Human Resources System (SABHRS). Costs were allocated in the executive budget based upon the number of full-time equivalent employees.

Data Network Services

The Information Services Division (ISD) of DofA charges agencies for the technology network that allows agency personal computers to be attached to the state mainframe and, via the mainframe, to other agency computers. Costs for this service are allocated to agencies based upon the projected

number of personal computers connected to the network each year. A fixed monthly rate per computer is used to determine the overall agency charge.

Messenger Service

The Mail and Distribution Program in DofA charges state agencies for interagency mail pickup and delivery services. Costs for these services are allocated to agencies based upon the volume of mail generated by, and number of daily deliveries to, each agency.

State Motor Pool Lease Vehicles

The state motor pool provides vehicles to agencies of state government on a lease basis. Unlike the daily rental, the vehicles are located at the agency location on a permanent basis. Agencies possessing the vehicles are assessed both a daily charge and a per mile charge for vehicle usage.

Rent

The General Services Division (GSD) of DofA charges rent to state agencies for costs relative to maintaining office and warehouse space in the capitol complex buildings managed by GSD. Included in the charges are utility, security and janitorial services, mechanical maintenance, and minor maintenance costs including such items as painting, lighting and carpeting. Warehouse costs are allocated to agencies based upon the amount of square footage of office warehouse space occupied; a fixed rate per square foot is used.

Grounds Maintenance

The Parks Division of FWP charges state agencies for grounds maintenance and snow removal at capitol complex buildings. Costs of these services are allocated based upon the square footage of office space occupied by a given agency.

Statewide/State Fund Cost Allocation Plan (SWCAP/SFCAP)

There are two state cost allocation plan components that are directly billed to agencies. Cost allocations are made to collect funds for the support of those state government operating costs that cannot be easily identified with particular funding sources. Collections are deposited to the general fund to offset a portion of those costs, which would otherwise be supported entirely with general fund. The two components are: 1) SFCAP (the state fund costs allocation plan), and 2) SWCAP (the statewide cost allocation plan). SFCAP is a direct charge to offset costs. SWCAP is based upon a rate negotiated by DofA each year with the state's federal cognizant agency (Health and Human Services). Among the programs for which operating costs are partially recovered through cost allocation plan collections are: 1) Procurement and Printing, State Personnel Division, and Accounting/Management Support in DofA; 2) a use charge on construction and renovation of certain state buildings; and 3) budget management services in the Office of Budget and Program Planning in the Governor's Office. Costs are allocated to agencies based upon the following: a) Procurement and Printing – depending upon the service, either requisitions processed, total operating costs, or equal allocations; b) State Personnel - the number of FTE authorized and classified, and the number of union covered employees; c) Accounting and Management Support - the number of accounting and cash transactions; and d) OBPP - the number of budget change documents, budget journal entries, executive planning process requests, and funding sources. Construction and renovation of certain state buildings is based on a user charge of 2 percent of the cost.

PUBLIC SCHOOL FUNDING – A PRIMER

OVERVIEW

The purpose of this section is to explain how K-12 education is funded. This section focuses on the major district and county funds for which the state supplies at least some of the funding.

Note: This primer is based on the current law method of funding K-12 education. In November 2004, the Supreme Court upheld a district court decision that the current funding methodology is unconstitutional, as it is not based on educationally relevant factors. The decision also concludes the schools are under funded. The 2005 Legislature will undertake the challenge to review the K-12 funding methodology to comply with a court deadline of October 2005.

The state share of district general fund revenue has declined over the years. In FY 1991, the state's share of district general fund revenue was 71.0 percent. As shown in Figure 3, the state's share of general fund revenue has fallen to 60.3 percent in FY 2005. The state's share includes property tax (the 95 mills) and other state tax revenues (primarily income tax). The local share includes property taxes levied for schools by the district or the county, as well as other district and county revenue. HB 124 block grants, which include reimbursements associated with HB 20 and SB417, are state payments to districts and county education accounts to reimburse these funds for revenues that now flow to the state.

Figure 3

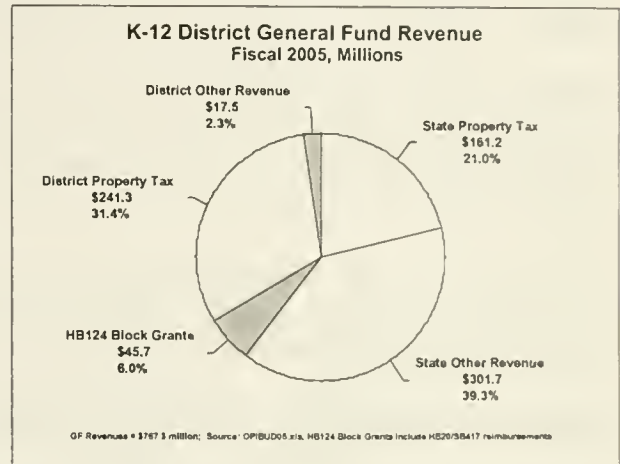
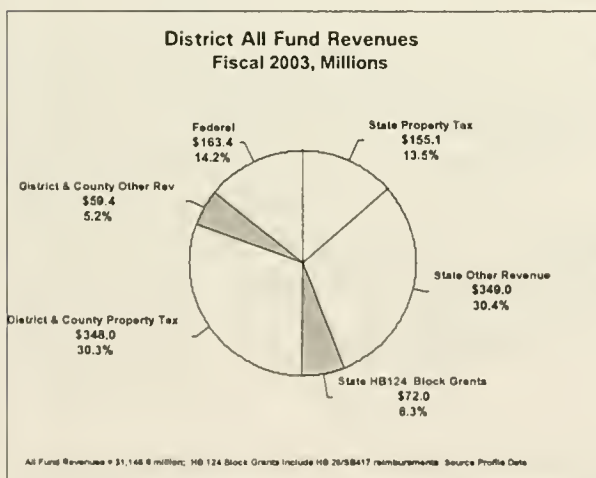


Figure 4



As shown in Figure 4, the state's share of revenue in all district funds was 43.9 percent in FY 2003. State HB 124 Block Grants add another 6.3 percent.

School districts typically may spend out of ten budgeted funds, and many schools spend out of smaller non-budgeted funds. Any fund that is funded by property tax must be budgeted.

The budgeted funds include: 1) general fund; 2) retirement fund; 3) transportation fund; 4) debt service fund; 5) bus reserve fund; 6) adult education fund; 7) tuition fund; 8) building reserve fund; 9) flexibility fund; and 10) technology acquisitions. This primer will focus on the first four of these, since state support in these funds is significant.

DISTRICT GENERAL FUND

The current system of school finance was established in HB 667, passed by the 1993 legislature and first applied to school funding in FY 1994. HB 667 created a system of funding schools in which the state mandates the limits within which a school district may budget its general fund expenditures. The maximum budget is the sum of the district's basic per-district entitlement, its per-ANB entitlement, and up to 200 percent of its special education allowable costs. The BASE (or minimum) budget for a district is the sum of 80.0 percent of the district's basic per-district entitlement, 80.0 percent of its per-ANB entitlement, and up to 140.0 percent of its special education allowable costs.

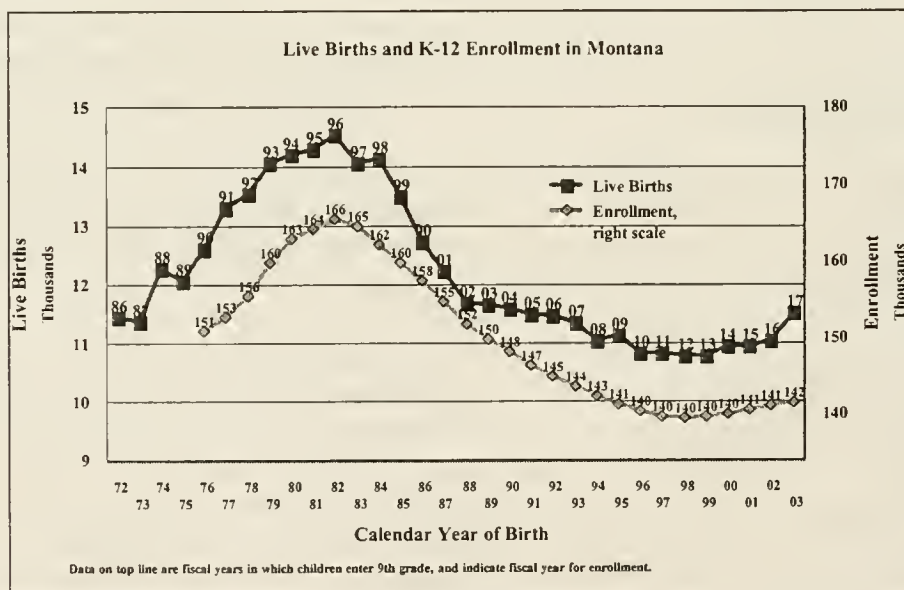
HB 667 allowed schools that had been budgeting above the newly created maximum budget in the past to continue budgeting at that level indefinitely. Subsequently, this grandfather clause was altered in HB 22 (1993 special session), which required district voters to approve any budget authority above the maximum budget.

In FY 1994 when the new system was first implemented, many schools had general fund budgets that were below the BASE budget. Districts with budgets below the BASE budget were required to incrementally increase budget authority and budget at the BASE level by FY 1998.

ANB and Maximum and BASE Budgets

The maximum and BASE budgets are related by a formula in statute to Average Number Belonging (ANB), which is enrollment in the prior year adjusted by teacher days. As shown in Figure 5, enrollment peaked in FY 1996 and has been declining since, mainly as a result of falling birth rates in the mid 1980's through the late 1990's. Recently births have increased, and it is expected that enrollment declines are expected to cease sometime in the next decade.

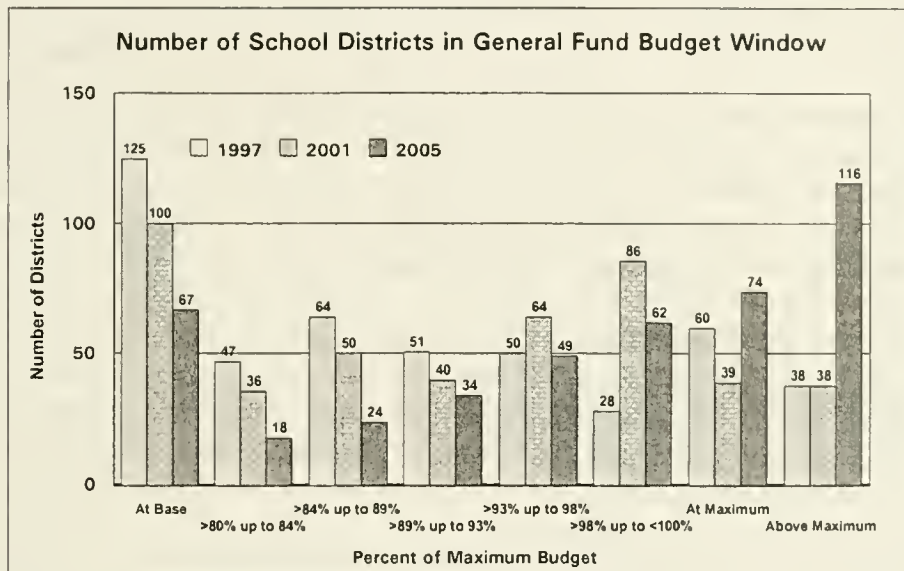
Figure 5



SB424, passed during the 2003 session automatically increases both per district and per-ANB entitlements by the rate of inflation, beginning in FY 2006. The rate of inflation is the Consumer Price Index – Urban Consumers as published by the US Department of Labor. It is a three-year average lagged two years.

Figure 6 shows the distribution of districts in the general fund budget window in FY 1997, 2001, and 2005 for all districts. The adopted general fund budget for each district is divided by the maximum budget for each year. The number of districts in each of the brackets is then counted. A large number of districts budget at the BASE level although the number has declined significantly. Many of these are schools that were required to increase spending to the BASE budget between FY 1994 and 1998.

Figure 6

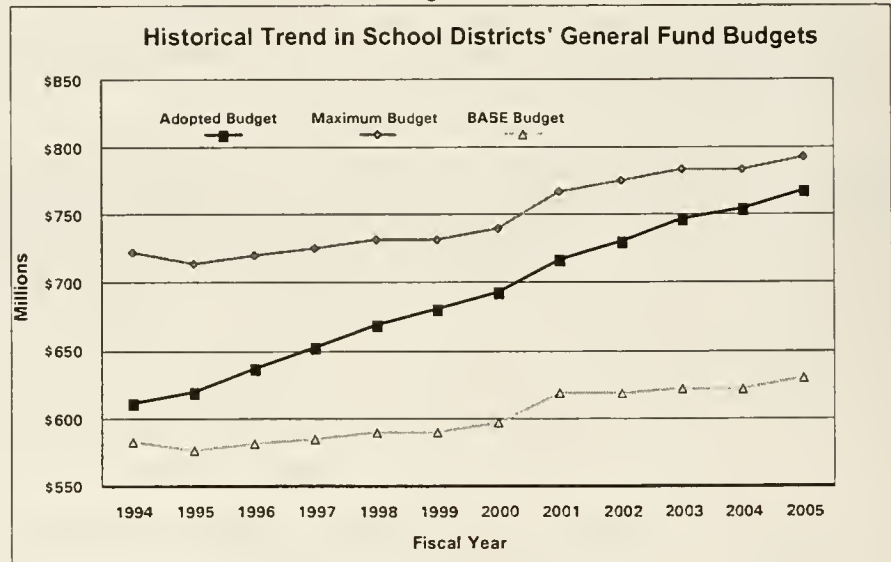


A large and growing number of districts are budgeting above 98.0 percent of the maximum budget. The number of districts budgeting in this area was 126 (27.0 percent of all districts) in FY 1997, 163 districts (36.0 percent) in FY 2001, and 252 districts (57.0 percent) in FY 2005. More schools are budgeting near the maximum because of declines in ANB, which in the absence of legislation, require lower maximum budgets. Beginning in FY 2002 and continuing through FY 2005, there are substantially more districts budgeting above the maximum budget. This is due to SB390, passed during the 2001 legislative session, which allowed districts to budget above the maximum budget for 5 years with voter approval. These are called “soft caps”. Districts that have used the soft cap rule for five years must budget at the maximum budget beginning in the sixth year. For some districts this will be in FY 2007.

As shown in Figure 7, the average general fund budget as a percent of the average maximum budget in FY 1994 was about 84.0 percent. This has risen to 97.0 percent in FY 2005, primarily as a result of reduced ANB slightly more than offset by legislated entitlement increases.

Between FY 1997, when ANB was at its peak, and FY 2005, ANB fell 10.4 percent. During the period, elementary ANB fell 14.0 percent and high school ANB fell 2.2 percent. In FY 2005 there were 17,027 fewer ANB served than in FY 1997. During the same period, basic entitlements were increased by the legislature 15.5 percent for both elementary and high school districts. Elementary per-ANB entitlements were increased 20.6 percent and high school per-ANB entitlements were increased by 14.8 percent. Between FY 1997 and FY 2005, the most severe declines in ANB occurred in the elementary grades. The most severe declines in the future will be in the middle school and high school grades.

Figure 7

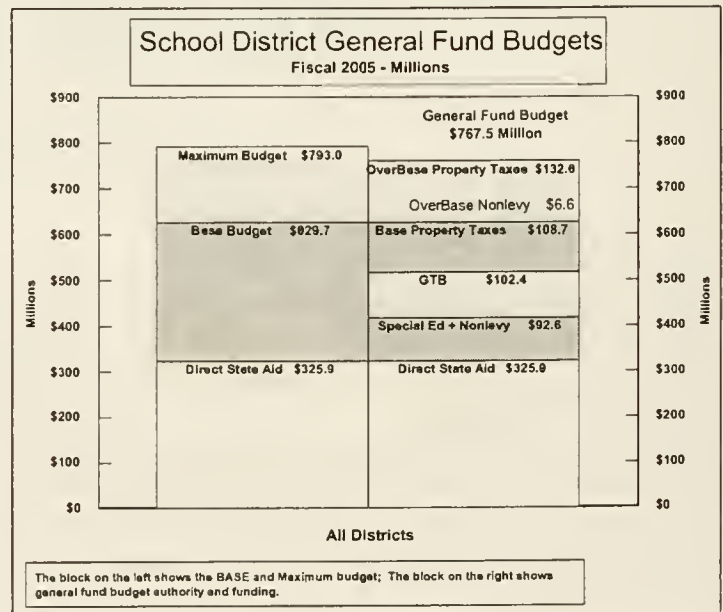


Funding the General Fund Budget

As shown in Figure 8, districts' general fund budgets are funded by state and local funds. State funds consist of direct state aid, state guaranteed tax base (GTB), state special education grants and state HB 124 Block Grants. The sources of local funding are nonlevy revenue (oil, natural gas, and coal receipts, investment interest), property taxes, and reappropriated fund balances.

Direct state aid is a grant from the state to the district. In FY 2005, direct state aid was 44.7 percent of total entitlements used to calculate the maximum budget. The direct state aid percent was 40.0 percent until FY 2000 when it was raised to 41.1 percent. The current level of 44.7 percent was instituted during the May 2000 special session for FY 2001. Direct state aid is the first source of revenue considered by a district. Because it is directly related to entitlements, the geographic distribution of direct state aid is directly related to where children live.

Figure 8



The portion of the budget above that is funded by direct state aid and below the BASE budget is called the GTB budget. This is funded by a combination of special education revenue from the state, state HB

124 block grants, nonlevy revenue, and fund balance reappropriated. The total of these revenue sources was \$66.9 million in FY 2005. The remaining area of the GTB budget is funded with state GTB aid and property taxes.

Special education revenue (\$32.3 million in FY 2005) reimburses districts for allowable costs associated with special needs children. Nonlevy revenues are revenues from taxes on oil, natural gas, and coal, and investment earnings and state HB 124 block grants. These revenues are distributed based on where the revenue was earned and are unrelated to the number of children in a district.

Beginning in FY 2002, HB 124 block grants are payments made by the state to districts to reimburse districts for revenue that now flows to the state. These revenues were motor vehicle taxes, taxes on financial institutions, and reimbursements from the state for legislated reductions in districts' business equipment property tax base in prior sessions. While HB 124 block grants are state appropriations to schools, they do not represent an infusion of new state money into district budgets, but rather replace money that used to be considered local revenue.

Reappropriated fund balances are unreserved general fund balances left over from the previous year (approximately \$11.0 million in FY 2005). A district may hold in reserve at most an amount equal to 10.0 percent of its general fund budget, and must reappropriate the rest in the ensuing year.

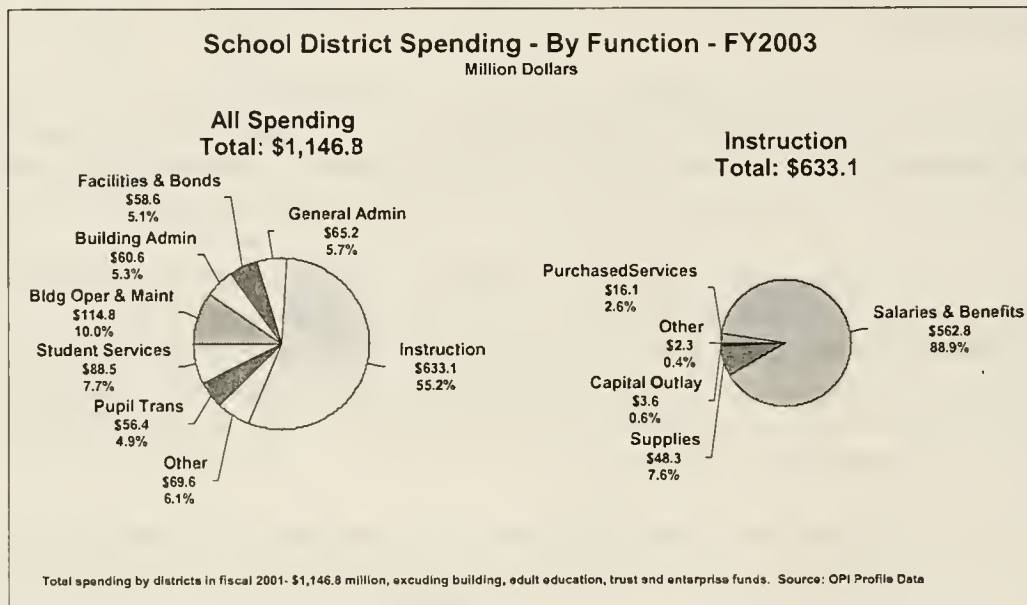
The remaining portion of the GTB area is funded by BASE property taxes (\$108.7 million in FY 2005) and state GTB aid (\$102.4 million in FY 2005). The amount of GTB aid a district receives depends on its relative wealth, as measured by taxable value per dollar of direct state aid. A relatively poor district's BASE mill levy generates local property taxes and a certain amount of GTB aid. The poorer the district, the more a BASE mill will be worth in terms of GTB aid. Statewide, the average ratio of GTB aid to BASE property tax revenue is a little greater than one. This may vary from zero for wealthy districts to over ten for poor districts.

Districts that budget above the BASE level must do so out of own-source revenue and tuition from other districts, parents, or the state. Some districts are able to use nonlevy revenue to fund a portion of this budget area, but the vast majority levy overBASE mills against property. OverBASE property taxes are \$132.6 million in FY 2005, and are a growing source of revenue funding district general fund budgets. OverBase property taxes were only \$34.8 million in FY 1994.

General Fund Spending by Function

Figure 9 shows spending by school districts by function. Instruction consumes approximately 55 percent of all spending by districts. Administration accounts for another 11.0 percent. The remaining functions include transportation, student services, spending on facilities and other expenses. These data do not include spending from the adult education fund, the building fund, trust funds, and enterprise funds.

Figure 9



A Short History of Legislative Changes in K-12 Funding

Figure 10 shows the impact of legislation on BASE aid entitlements since FY 1994.

Figure 10
School District Entitlements - FY 1994 - 2005

Component	FY1994 Actual	FY95-97 Actual	FY1998 Actual	FY1999 Actual	FY2000 Actual	FY2001 Actual	FY2002 Actual	FY2003 Actual	FY2004 Actual	FY2005 Actual
Bill Authorizing Entitlement Change	HB667	HB22	HB47	HB47	SB100	HB4	HB121	HB121	SB424	SB424
Basic (Per District) Entitlements										
Elementary	\$18,000	\$17,190	\$18,000	\$18,000	\$18,000	\$18,540	\$18,889	\$19,244	\$19,456	\$19,859
Percent Change		-4.5%	4.7%	0.0%	0.0%	3.0%	1.9%	1.9%	1.1%	2.1%
High School	\$200,000	\$191,000	\$200,000	\$200,000	\$200,000	\$206,000	\$209,873	\$213,819	\$216,171	\$220,656
Percent Change		-4.5%	4.7%	0.0%	0.0%	3.0%	1.9%	1.9%	1.1%	2.1%
Per ANB Entitlements										
Elementary	\$3,500	\$3,343	\$3,376	\$3,410	\$3,529	\$3,763	\$3,834	\$3,906	\$3,949	\$4,031
Percent Change		-4.5%	1.0%	1.0%	3.5%	6.6%	1.9%	1.9%	1.1%	2.1%
High School	\$4,900	\$4,680	\$4,726	\$4,773	\$4,821	\$5,015	\$5,109	\$5,205	\$5,262	\$5,371
Percent Change		-4.5%	1.0%	1.0%	1.0%	4.0%	1.9%	1.9%	1.1%	2.1%
Per ANB Decrements										
Elementary	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20
High School	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50
Per ANB Decrement Stop Loss										
Elementary ANB	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
High School ANB	800	800	800	800	800	800	800	800	800	800
GTB Guarantee Ratio	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%
Base Budget Components										
Direct State Aid	40.0%	40.0%	40.0%	40.0%	41.1%	44.7%	44.7%	44.7%	44.7%	44.7%
Guaranteed tax base aid	40.0%	40.0%	40.0%	40.0%	38.9%	35.3%	35.3%	35.3%	35.3%	35.3%
Special Ed to Districts	\$28,533,557	\$28,916,427	\$28,532,882	\$28,724,419	\$30,049,664	\$30,323,178	\$30,030,295	\$30,909,484	\$30,940,660	\$32,320,398

Bill and session year: HB667, 1993; HB22, Nov SS,1993; HB47, 1997; SB100, 1999; HB4, May SS,2000; HB121, 2001; SB424, 2003.

The level of entitlements under HB667 was in operation for FY 1994 only. The legislature then passed HB22 during the special session of 1993 and cut entitlements by 4.5 percent for FY 1995 through FY 1997. On average statewide, ANB was increasing in these years.

HB47 was passed by the 1997 legislature and raised per-ANB entitlements beginning in FY 1998 by 1 percent per year, and the basic entitlement in FY 1998 by 4.7 percent.

SB 100 was passed by the 1999 legislature and increased per-ANB entitlements by 1 percent for high schools and by 3.5 percent for elementary schools in each year of the 2001 biennium. The direct state aid percent was raised from 40.0 percent to 41.1 percent in FY 2000 and to 41.8 percent in FY 2001. SB 100 also increased special education funding by approximately \$1.5 million per year.

Then in special session in May 2000, HB 4 further raised the per-ANB entitlements in FY 2001 by 3.0 percent for both elementary and high school, and raised the direct state aid percent to 44.7 percent.

During the 2001 legislative session, HB 121 raised entitlements by 1.88 percent in FY 2002 and by an additional 1.88 percent in FY 2003. In addition, SB 390 created a new flexibility account from which districts could spend for nearly the same purposes as the district general fund. The legislature funded the district flexibility accounts with \$5.0 million in state general fund dollars. This was reduced to \$4.3 million in the August 2002 special session.

During the 2003 legislative session, SB424 raised entitlements by 1.1 percent in FY 2004 and by 2.1 percent in FY 2005. In addition, entitlements were tied to inflation increases beginning in FY 2006. The inflation factors for FY 2006 and FY 2007 are 2.1 percent and 2.19 percent respectively.

In June 2004, District Court Judge Sherlock declared the current system of K-12 funding unconstitutional, stating it was not based on "educationally relevant factors". The decision also concluded that K-12 education is under-funded. The decision was upheld by the Montana Supreme Court in November 2004. The state was given a deadline of October 2005, to comply with the court findings. The 2005 Legislature is tasked to resolve this issue.

Special Education

The state will pay approximately \$36.5 million in FY 2005 in special education grants and reimbursements to districts and special education cooperatives. Special education cooperatives are groups of districts offering special education services. Districts receive about 95.0 percent of this money in their general funds and spend it for services to children with various disabilities or impairments. The remainder flows to special education cooperatives that provide special education services to its members. The disabilities range from speech-language impairments and physical impairments to multiple disabilities.

In FY 2003, districts and coops spent \$65.7 million in state and local contributions and \$21.5 million in federal contributions on the allowable costs associated with the education of impaired students. Allowable costs are defined by the state, which provides grants for special education instruction and related services (70 percent). State reimbursements (25 percent) are made to schools with extraordinary special education costs. As costs have risen, the amount of reimbursements has also

risen. The remaining 5 percent is distributed to special education cooperatives to cover costs related to travel and administration.

The proportion of the total state appropriation distributed in the form of reimbursement for disproportionate costs grew both in total dollars and in the number of districts receiving reimbursement for disproportionate costs through FY 2001. The funding for disproportionate reimbursement was revised in FY 2002 to hold constant the proportion of funds distributed under reimbursement for disproportionate costs and shift funding back to instructional and related services block grants. Today, any increase in funds distributed for purposes of reimbursement of disproportionate costs is due to an increase in overall appropriations for special education.

The state special education grants and reimbursements flow to district general funds and are incorporated in calculating a district's maximum and BASE general fund budget limits. For each dollar increase in district receipts of state special education dollars, the maximum budget of the district increases by \$2.00 and the BASE budget increases by \$1.40. Increases in special education receipts by districts also increase the state GTB aid paid to a district, since GTB aid depends on the level of the BASE budget.

Special education students were about 12.8 percent of the student population in FY 2003. Enrollments of special education students grew by close to 2 percent per year between FY years 1991 and 1994, but growth has been less than 1 percent since then. A new state funding system was put in place in FY 1994 that granted districts state special education dollars based on the number of ANB in the entire district. The old system had granted such dollars based on the number of identified special education students in each district.

The amount the state appropriates in special education grants to districts and cooperatives remained between \$32.0 and \$33.0 million between FY 1989 and 1999, but has risen to \$36.5 million in FY 2005. Districts and coops spent \$40.9 million in FY 1990 for special education programs and \$87.2 million in FY 2003, an annual growth rate of 6.0 percent per year. The state share of these costs has fallen commensurately and the local share of special education costs has risen from \$3 million in FY 1990 to \$31 million in FY 2003.

Districts spend more on special education students than regular students. Spending for special education students was 164.0 percent of spending for regular students in FY 2003, and that percentage was up from 161.0 percent in FY 1993.

Voting Rules

Many of the decisions regarding the level and funding of general fund budgets must by law be referred to district voters. Beginning in FY 2001, the general fund voting provisions for districts adopting a general fund budget between the BASE and the maximum budget limits were amended to require voter approval for an increase in overBASE property tax revenue. Previous law had required a vote in order to increase ensuing year budgets above current year budgets regardless of the property tax revenue consequences. Under the new law, if an increase in budget authority can be funded without increasing overBASE property taxes revenue, the budget increase does not require voter approval. A 4 percent limitation on annual budget growth, or on annual budget growth per ANB, was in effect until July 1, 2001. HB 164, passed during the 2001 legislative session eliminated the growth cap, and districts may now increase their general fund budget by any amount up to the maximum with voter approval.

The 1999 legislature also changed the budgeting rules for districts with declining enrollments. General fund budget limitations were amended for districts that are: 1) budgeting between the BASE and maximum budgets; and 2) have declining ANB populations. If ANB declines less than 30.0 percent and the district's current year adopted budget exceeds the district's ensuing year maximum budget, the district may adopt a budget for the ensuing year that is the greater of the current year budget or the ensuing year's budget, subject to voter approval. The district may not exceed its maximum budget limit for more than five consecutive years.

If ANB declines by 30.0 percent or more and the district's current year adopted budget exceeds the ensuing year's maximum budget, the district must reduce the range between the district's current year budget and the ensuing year's maximum budget by:

- 20.0 percent in the first year
- 25.0 percent in the second year
- 33.3 percent in the third year
- 50.0 percent in the fourth year
- the remainder of the range in the fifth year

Districts that have general fund budgets exceeding the maximum budget must annually ask voters to approve the part of the budget in excess of the maximum. However, the budget adopted for the current year may not exceed the lesser of: 1) the adopted budget for the prior year; or 2) the district current maximum budget plus the over-maximum budget amount adopted for the prior year.

If a district's budget in the current year is below the BASE budget in the upcoming year, either due to ANB increases or legislated increases in entitlements, district trustees must increase the budget to the BASE budget level and no voter approval is required.

Effective in FY 2000, the regular school and trustee election date is changed to the first Tuesday after the first Monday in May. Only one levy election may be held in a calendar quarter.

DISTRICT TRANSPORTATION BUDGET

Montana law provides for two types of public school transportation - a publicly funded school bus program and/or individual transportation contracts with a student's parents or guardian. School bus transportation may be provided directly by the school district, or the trustees of a district may contract with a private contractor to provide bus transportation for eligible students.

The trustees of a district may provide school bus transportation to any pupil of a public or private school. However, the district will receive reimbursement from the state and county only for eligible transportees. An eligible transportee must:

- Be a resident of the State of Montana and attend a public school in Montana
- Be between the ages of 5 and 21 or be a preschool child with disabilities between the ages of 3 and 6
- Reside at least 3 miles from the nearest operating public elementary school or high school
- Be considered to reside with his or her parent or guardian, who maintains legal residence within the boundaries of the district furnishing the transportation, regardless of where the eligible transportee lives when attending school

The trustees of a district are not required by law to provide pupil transportation unless directed to do so by the county transportation committee. However, if the trustees decide to furnish transportation for any eligible transportee, they must ensure transportation for all eligible transportees.

On-Schedule Costs

A district's transportation budget is funded by receipt of state reimbursements for on-schedule costs, an amount that is matched by the county, and by district revenues, which fund "over-schedule" costs.

On-schedule costs are defined by the legislature and are expressed on a per mile basis. The per mile schedule costs depend on the size of the bus. Before FY 2004 these costs were adjusted depending on the extent that the bus is filled with riders. On-schedule costs are determined as the product of the per mile amount times miles traveled (including miles within the 3 mile zone) times 180 days. The state general fund reimbursement is one-half this amount or one-half the amount a district budgets for transportation, whichever is less. The county must match the state reimbursement amount with funds derived from the county school transportation fund. County revenues in the county transportation fund include non-levy revenue and property tax revenues.

District over-schedule costs are the difference between the transportation fund budgeted amount and state and county on-schedule reimbursements. Some districts are able to provide transportation services for the on-schedule amount, but the vast majority of districts incur costs above the on-schedule amount. On-schedule costs vary between 95 cents per mile per day and \$1.80 per mile per day. Larger districts generally have higher per mile costs than small districts. Small districts have generally higher costs per ANB, and per ANB per mile, than do large districts.

Districts fund the over-schedule amount through a combination of non-levy revenues and district property taxes. District trustees may budget the over-schedule amount at their discretion and are not required to ask voters to approve that level. For on-schedule costs, the county superintendent determines the required property tax requirements, and the county commissioners set the required levy.

In FY 2003, total district spending on transportation was \$48.8 million. On schedule costs were \$20.8 million, of which half was paid by the county and half by the state.

Some districts budget for transportation but do not engage in providing transportation. These districts do not own buses and do not contract with a private bus company. In many cases, these districts coordinate their transportation needs with a nearby district. For instance, many elementary districts coordinate with their high school district, if the high school is in the same community.

Approximately one-third of the bus routes in Montana are contracted with private bus companies. These contracts are usually observed in the larger districts. Some small districts, however, also contract and may contract with many private individuals to provide bus service. Contracts in the larger districts are often multi-year, and some provide inflation adjustments and/or gas price adjustments. The contracts are usually on a per mile basis or on a yearly basis for a set number of miles per day. The bus company usually must provide specially equipped buses and bus aides if necessary.

School districts may also contract with parents or guardians of pupils in need of transportation. Under section 20-10-142, MCA, the state and county must reimburse a district that makes a contract with a parent or guardian for transportation of eligible transportees at a minimum rate of 25 cents per mile per

day. The district may contract with a parent at a higher rate, and in fact federal rules regarding transportation of special needs students require that parents be reimbursed by the district at 29 cents per mile. Allowable miles are determined by multiplying the distance between the eligible transportee's residence and school, minus 6 miles. The total reimbursement is limited to one round trip per day. Districts with parents who transport their children to the nearest bus stop on an approved route are also reimbursed 25 cents per mile per day, with 3 miles deducted from the distance between the home and the bus stop.

RETIREMENT FUND

School districts employing personnel who are members of the teachers retirement system or other defined retirement systems must establish retirement funds from which to pay the districts' contributions to the systems. The amount each district must pay into the retirement fund is set by statute and is a set percentage of the employee's annual wage, and includes payments to the retirement system, social security, Medicare and unemployment insurance. Thus the spending requirements in the retirement fund increase with increases in wages and in the number of employees. Also, because teacher wages are paid from the district general fund, the level of spending in the retirement fund is closely related to the level of spending in the general fund. Retirement costs associated with salaries in other state and federal funds are also paid for out of the district retirement fund.

The retirement fund is managed at the county level. The county collects the money and deposits it in district retirement accounts. The district then pays for the retirement contributions. The county retirement fund is funded by nonlevy revenue, state GTB, and local property taxes. A county is eligible for GTB if its taxable value per ANB is less than 121.0 percent of the state average taxable value per ANB. The amount of state GTB varies inversely with the value of a county's taxable property per ANB. Thus, less wealthy counties receive more GTB aid than do relatively more wealthy counties.

The retirement fund has been a nonvoted fund. That is, the county superintendent determines the amount of the levy, and the county commissioners fix and set the levy without putting the issue before the voters.

The total payment to districts by counties in FY 2003 was \$96.4 million. The state GTB payment to counties for retirement purposes was \$21.8 million in FY 2003.

Beginning in fiscal 2005, retirement costs for federal employees must be paid out of federal funds, not state or local funds, with exceptions for employees funded by a special education cooperative inter-local fund, the districts' food services fund and any other state or local fund.

DEBT SERVICE FUND

School districts utilize a debt service fund to make debt service payments on bonds that have been sold to investors. The sale of bonds may be for purposes of capital construction, purchase of certain equipment or vehicles, refinancing past bond issues, or for funding a judgment against a district. SB 424 (2003 session) expanded eligibility for the program to those districts with bonds that were sold before July 1, 1991.

Under a formula in statute, a school district's facility reimbursement is a set dollar amount per ANB in the district, which varies depending whether the student is in grades K-6, 7-8 or in high school. The K-6 entitlement is \$300 per ANB, the 7-8 entitlement is \$370 per ANB and the high school entitlement is \$450 per ANB. In order for a school to receive a capital outlay reimbursement from the state, it must be

GTB-eligible. Its taxable value per ANB must be below 140.0 percent of the state average taxable value per ANB. If a district is GTB-eligible, its school facility reimbursement is the lesser of its actual debt service expenditures or the calculated reimbursement. When the total statewide available reimbursements required exceed the amount available in the state appropriation, the reimbursements are prorated to the eligible districts.

The number of districts receiving school facility payments has grown from 14 districts in FY 1994 to 157 districts in FY 2004. The state appropriation has grown from \$1.0 million in FY 1994 to \$8.3 million in FY 2004. In the 1990's, the growth in demand by districts for school facility payments has outstripped the growth in the level of the state appropriation. In FY 1994, the pro-rata percentage was 90.0 percent and in FY 1998 it was 79.0 percent. Because of the increase in the state appropriation in FY 2004, the pro-rata percentage was at 100 percent.

The legislature passed SB 457 during the 2001 legislative session which allowed districts to use up to 25.0 percent of their federal impact aid revenues for debt service. Federal impact aid revenues flow mostly to districts on Indian reservations.

TOTAL SPENDING ON K-12

The figure below shows historical total spending by districts on K-12 education between 1991 and 2003. Also shown is the state, federal and local sources of revenue. Equalized state revenue is revenue received by districts that is based on number of children in the district, or the costs of delivering services to children in the district. Non-equalized state revenue is revenue that is distributed without respect to the number of children in the district. These revenues include HB 124 block grants and the remaining property tax reimbursements (HB20/SB417). Federal revenues include those that pass through OPI as well as direct federal payments to districts (impact aid monies). Local sources are property taxes, nonlevy revenue and cash reappropriated.

As shown in the figure, total spending on K-12 grew 55.0 percent between 1991 and 2003 while inflation was 36.0 percent. In the same period, state equalized funding grew 22.9 percent, total state funding grew 38.4 percent, federal funding grew 162.3 percent, and local sources grew 56 percent.

Figure 11
Historical K-12 Spending Data, by Source of Spending
1991-2003

Fiscal Year	Equalized State Funding	Nonequalized State Reimbursements	Total State Funding	Local	Federal	Total Spending	Inflation 2003 Dollars
1991	410,068,339	6,194,034	416,262,373	261,244,899	62,292,449	739,799,721	73.5
1992	410,683,944	6,194,034	416,877,978	288,276,952	67,504,393	772,659,324	75.9
1993	449,284,428	6,194,034	455,478,462	280,496,495	71,248,888	807,223,844	78.3
1994	449,022,117	6,194,034	455,216,151	316,568,353	78,593,987	850,378,491	80.3
1995	454,407,079	6,194,035	460,601,114	322,033,178	82,291,327	864,925,619	82.6
1996	456,761,270	14,107,524	470,868,794	331,652,997	85,761,667	888,283,458	84.8
1997	461,430,512	14,107,524	475,538,036	356,982,459	87,510,909	920,031,404	87.3
1998	475,819,055	14,107,524	489,926,579	363,980,491	98,565,659	952,472,728	88.8
1999	463,136,715	14,107,524	477,244,239	392,463,959	106,952,451	976,660,649	90.4
2000	478,973,310	19,716,889	498,690,199	380,507,204	124,778,384	1,003,975,788	93.0
2001	504,920,062	43,932,391	548,852,453	386,035,173	123,577,327	1,058,464,953	96.1
2002	489,205,888	77,646,820	566,852,708	385,032,759	143,671,140	1,095,556,607	97.8
2003	504,044,202	71,967,152	576,011,354	407,450,946	163,400,823	1,146,863,124	100.0
Cumulative Growth	22.9%	1061.9%	38.4%	56.0%	162.3%	55.0%	36.0%

Source: State data from SBAS, SABHRS; Federal Data and Total Spending from OPI Profile Data; Local data by difference

Equalized state funding are monies distributed on the basis of ANB or other educationally relevant factor.

Non-equalized funding is HB 124 block grants, HB 20 and SB 417 reimbursements, that supplanted local revenues, and are not necessarily distributed on the basis of educationally relevant factors.

For information about the K-12 executive budget, please [Legislative Budget Analysis](#), Volume 4, Section E, Office of Public Instruction.

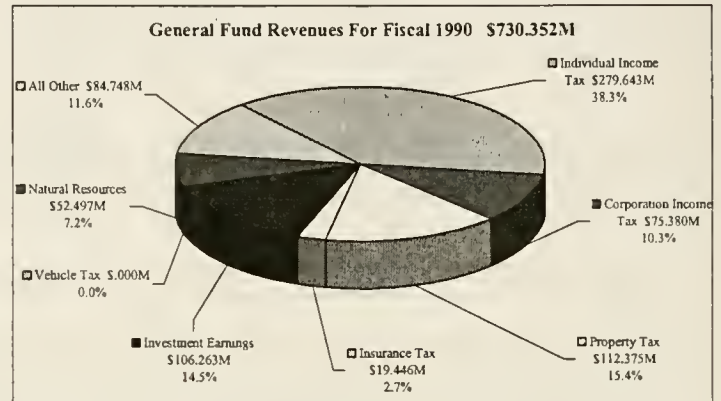
GENERAL FUND - HISTORICAL PERSPECTIVE

REVENUE HISTORY

The recent history of finances in the state of Montana has followed an upward trend. On both the revenue and expenditure side, Montana state finances have increased significantly.

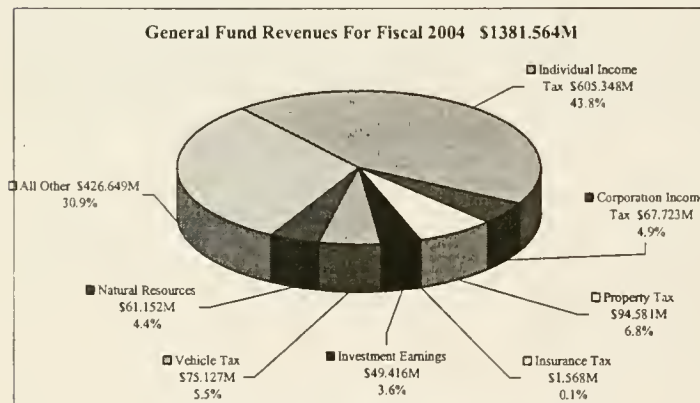
From FY 1990 through FY 2004, the relative importance of the revenue components has changed only slightly. In FY 1990 as now, the largest component of general fund revenue was collections from individual income tax. As shown in Figure 12, individual income tax made up 38.3 percent of total general fund revenues. Property tax collections were next, with collections amounting to 15.4 percent of all general fund revenues. Investment earnings follow, adding 14.5 percent of the collections to the revenue base.

Figure 12



In FY 2004, individual income tax collections increased slightly in terms of its relative importance to the general fund, now making up 43.8 percent of total general fund collections. Property tax collections are only 6.8 percent of general fund collections, while investment earnings fell in relative importance to only 3.6 percent of total revenues. Total general fund revenues are shown in Figure 13.

Figure 13



Over the 15-year period spanning from fiscal 1990 through FY 2004, revenues have increased substantially. General fund revenues during the period have increased by over \$651.2 million, from \$730.4 million in FY 1990 to \$1,381.6 million in FY 2004. This represents an increase of more than 89.2 percent in nominal terms. In real terms, when adjusted for inflation, the change is over 42.8 percent. This rate of growth is significant and can be traced almost exclusively to the increases in individual income tax and property tax collections. Since FY 1996,

individual income tax has increased by 25.1 percent, and the general fund portion property tax has decreased by 21.7 percent in real terms. Figure 14 depicts the cumulative increases of general fund revenues in both dollar and percent terms for the 15-year period.

EXPENDITURE HISTORY

General fund expenditures have also increased substantially since FY 1990. A portion of the increase is attributable to increased state spending due to inflationary pressures. Further increases can be explained by growth in human service caseloads, prison population, and average number belonging (ANB) increases.

Figure 14

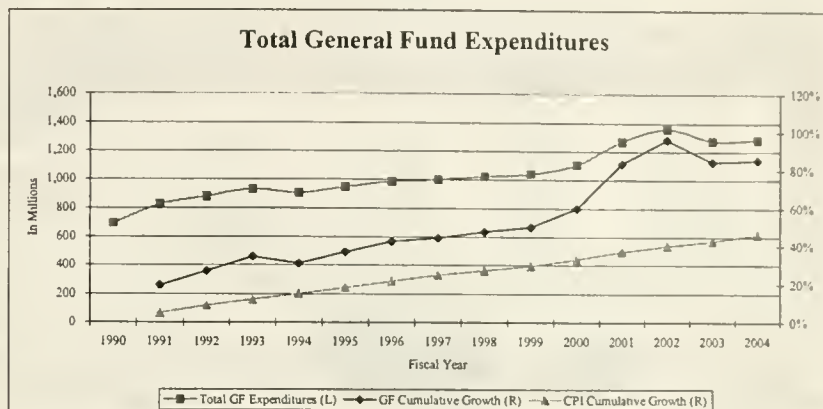


Figure 15

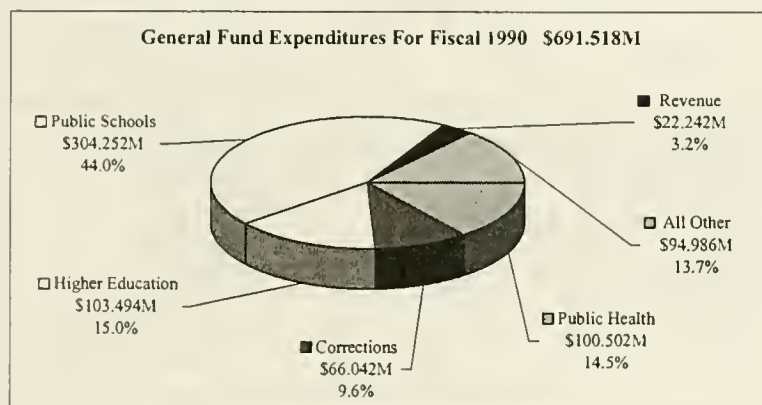
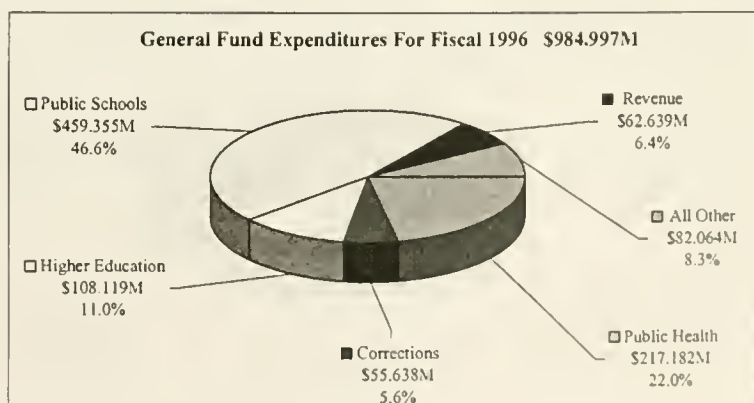


Figure 15 shows the general fund expenditure components for FY 1990, along with the dollars expended and the percent of total general fund spending. In all years, expenditures for public schools are the greatest portion of total general fund expenditures, consuming 44.0 percent of general fund dollars. In FY 1990, expenditures for higher education were the second highest area, utilizing 15.0 percent of general fund revenues. At that time, Public Health expenditures were only 14.5 percent of total general fund spending.

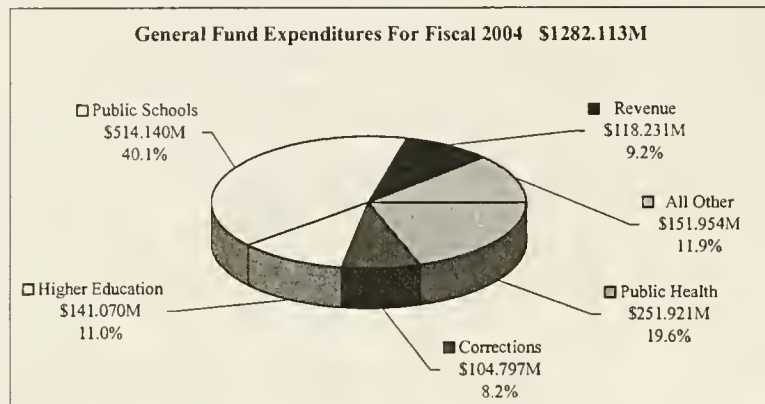
In FY 1996, the legislature reorganized public health entities, which moved health service related functions into one agency. Consequently, general fund expenditures for public health accounted for 22.0 percent of total general fund expenditures. The expenditures for higher education increased in the period between fiscal 1990 and fiscal 1996 by 4.5 percent and dropped to the third highest area in general fund terms. Public school funding was also increased in FY 1996. Consequently, general fund support for schools increased by 51.0 percent and account for 46.6 percent of total general fund expenditures. Figure 16 shows the FY 1996 general fund expenditures.

Figure 16



By FY 2004, public school support dropped in relative weight to the general fund support. As seen in Figure 17, public schools consumed 40.1 percent of available general fund dollars. Public health, the second largest consumer, expended 19.6 percent of the total general fund. Higher education share of general fund expenditures by FY 2004 was at 10.2 percent of the total.

Figure 17



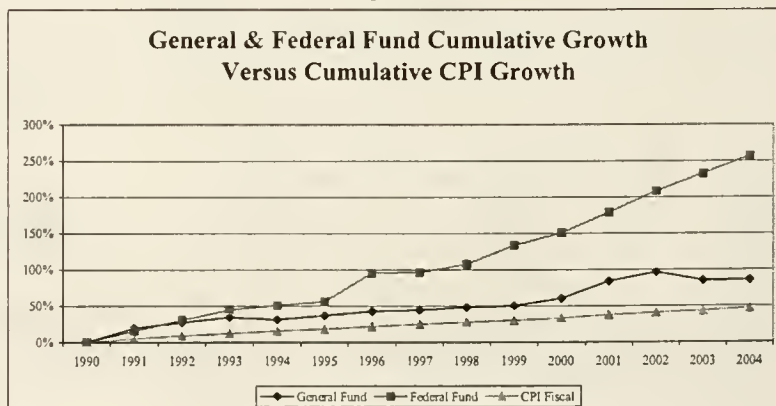
During the 8-year period between FY 1996 and FY 2004, total general fund expenditures have increased from \$985.0 million to \$1,282.1 million. This corresponds to a nominal increase of 30.2 percent but an increase in real terms of 9.7 percent. The greatest portion of this increase is seen in the three program area, public schools, public health, and higher education. Since FY 1996, public school expenditures have increased from \$459.4 million to \$514.1 million, an

decrease of 8.5 percent in real terms. Public health expenditures have increased from \$217.2 million to \$251.9 million, decreasing over 4 percent in real terms. Higher education has experienced increases from \$108.1 million to \$141.1 million in the six years. This represents a 10 percent increase in real terms.

FEDERAL FUND EXPENDITURES

While general fund expenditures have increased cumulatively over 56.2 percent in real terms since FY 1990, federal funds have increased by 210.2 percent. Montana has become substantially more dependent upon federal funds to support its expenditures, as illustrated in Figure 18.

Figure 18



Annual growth for the general fund has been 4.5 percent in nominal terms over the 15-year period. Nominal annual growth in federal funds is 9.5 percent. The average annual nominal growth for both fund sources is 6.9 percent, or 4.1 percent when adjusted for inflation, as shown in Figure 19.

In Figure 20, the ratio of general fund to federal fund has changed significantly since FY 1990. Where federal funds paid for approximately 39.3 percent of state expenditures in FY 1990, they now support well over half.

Figure 19

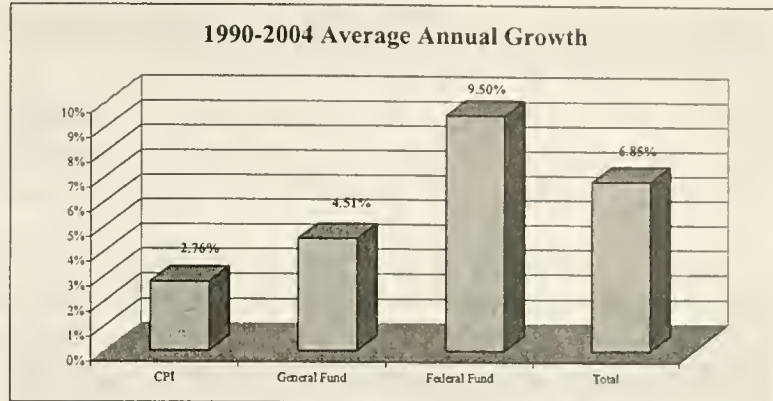
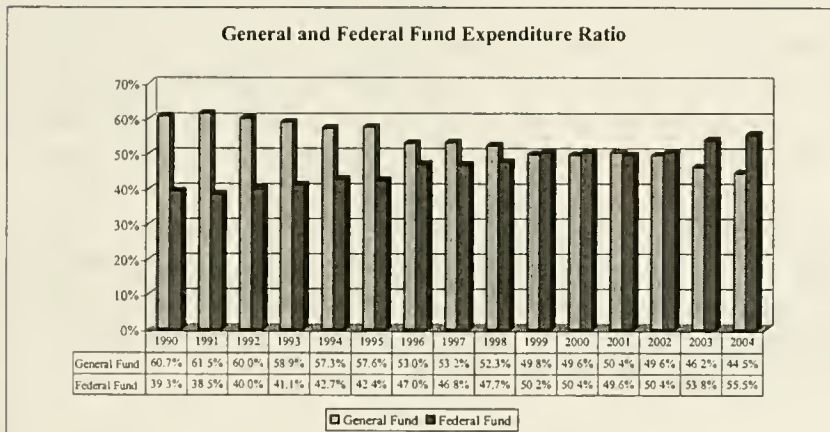


Figure 20

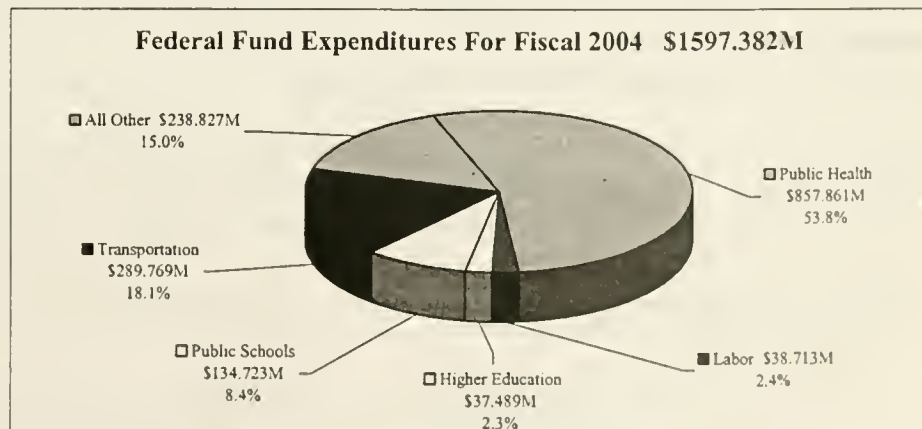


The largest area of federal support goes to public health expenditures. In FY 2004, Montana received over \$857.9 million in federal aid for public health programs. This corresponds to 53.8 percent of the federal funds received. Transportation received \$289.8 million in federal aid or 18.1 percent of all federal funds, and public schools received \$134.7 million or another 8.4 percent of the federal funds provided to Montana. Figure 21 presents the

entire breakout of federal fund expenditures for FY 2002.

General fund revenues and expenditures and federal funds have all increased since FY 1990. Typically, the increases have surpassed inflation. The state has directed the increased revenues to all budgets, but the greatest increases, in dollar terms, have been expended in the largest budgets, public schools, public health, and higher education. Finally, Montana has grown increasingly dependent on federal funds to support these programs.

Figure 21



GENERAL FUND STATUS SHEET

The general fund status sheet (GFSS) is analogous to your personal checkbook register. Your bank balance fluctuates either up or down as you make deposits and expend monies. Similarly, the general fund status sheet simply measures the state's financial condition as the legislature adjusts revenue flows (taxation policies) and appropriates funds (authorizes expenditures).

The general fund status sheet is prepared during legislative sessions in order to provide the legislature with a current projection of the financial status of the general fund account. This budgetary status sheet is usually prepared at least once a week and serves as a "work in progress" tool to assist the legislature in balancing the state's general fund budget. Financial information on revenue estimates, taxation legislation, and appropriation measures are the basic components of the general fund status sheet. The status sheet is usually prepared on Fridays and distributed either late Friday night or early Saturday morning.

The starting point for the status sheet is the projected general fund balance *before* any legislative action has been taken. This balance is based on revenue estimates adopted by the Revenue and Transportation Interim Committee (RTIC) on November 16, 2004, agency base budgets for fiscal 2004 as assumed for fiscal 2006 and 2007, LFD estimates for all statutory appropriations, fund balance adjustments, transfers, and the Executive Budget recommendations for supplemental appropriations.

The status sheet also shows any proposed legislation that has general fund fiscal impact (revenue or disbursement). These bills are posted to the document after any committee takes positive executive action. Subsequent amendments to bills are also incorporated into the document once they have been adopted by a committee. The projected ending balance *after* legislative action to date is provided to show the legislature a "point in time" status of the general fund account.

The status sheet also includes all general fund bills that could change the level of spending for state agencies. These bills, categorized as "potential appropriations," result from legislation that changes the duties and functions of state agencies without making a corresponding appropriation adjustment. These adjustments are considered by the House Bill 2 Conference Committee toward the end of the legislative session. These "potential" spending changes are *not* included in the projected ending balance until *after* legislative action has been taken.

Attached to the status sheet is a summary of budget development by joint appropriation subcommittees. These summaries show the budgets as approved by the subcommittees, as compared to the base budget for fiscal 2004. Both general fund and all funds detail are provided.

The information shown on the next page is an example of what the first general fund status sheet will look like.

LFD staff are available to assist legislators in interpreting the general fund status sheet.

Legislative Fiscal Division General Fund Status Sheet 2005 Biennium (Figures In Millions)			
12/21/2004	10:04 AM	90 th Legislative Day	Status #16
Fiscal Condition Without Legislative Action			
Beginning Fund Balance(Without Feed Bill & Supplementals)		\$27,167	+
Revenue & Transportation Committee Revenue Estimates		2,527,919	+
Base Appropriations Using Fiscal 2002 +Statewide Adjustments		(2,407,669)	-
Estimated Reversions and 2005 Legislative Session		1,492	+
Estimated Statutory Appropriations		(260,118)	-
Estimated Transfers		(31,780)	-
Estimated Adjustments & Residual Transfers		0,000	+
Ending Fund Balance Without Legislative Action		=	(\$142,989)
Summary of Legislative Action			
Revenue Adjustments			
HJR 2 Revenue Estimates		-	(5,751)
House Taxation	6,777		
House Floor	No Change		
Senate Taxation	(12,528)		
Senate Floor	No Change		
Conference	Not Required		
Revenue Legislation (See Table 1 For Detailed Bill Listing)		+	135,706
Appropriation Adjustments			
HB0002 General Appropriations Act	Present Law	New Proposal	+
General Government & Transportation	(14,153)	4,242	
Health & Human Services	(26,887)	25,921	
Natural Resources & Commerce	(0,092)	5,407	
Corrections & Public Safety	(10,601)	11,757	
Education	79,674	12,640	
Totals	\$27,941	\$59,967	
Other Appropriation Legislation (See Table 1 For Detailed Bill Listing)		-	(28,653)
Total Legislative Action		+	\$189,210
Fiscal Condition With Legislative Action			
	(\$142,989)	+	\$189,210 = \$46,221
HB152 increases the general fund emergency statutory appropriation from \$12 million to \$16 million. Since the base statutory appropriation does not include any amount for emergencies, the \$16 million is not included in the above projected balance.			

Figure 22

Legislative Fiscal Division General Fund Status Sheet 2005 Biennium (Figures In Millions)				
12/21/2004	10:04 AM	90 th Legislative Day	Status #16	
Table 1 - Detail of Legislative Action				
Bill Number	Short Description of Proposed Legislation	Revenue Impact	Appropriation Impact	Potential Impact *
				Total Impact
	Total of Legislative Action	\$135,706	(\$28,653)	(\$1,212)
				\$105,841
* Potential appropriations result from legislation changing the duties and functions of state agencies without a corresponding appropriation adjustment. These adjustments will be considered in House Bill 2 conference committee towards the end of the legislative session.				

Figure 23

INDEX TO OTHER LFD BUDGET REFERENCE DOCUMENTS

In addition to the *Legislative Budget Analysis – 2007 Biennium* (Volumes I through IV), there are several other reference documents that legislators and other interested parties can use as a source of information concerning budget and other fiscal matters. A limited number of reports of past biennia are available for reference in the LFD office (photo copies of pages of interest can be made). Training publications and brochures are available for distribution and on the LFD website. Check with an LFD staff member for assistance (see staff list on page xiii).

PREVIOUS REPORTS

The *Legislative Budget Analysis* is prepared at the beginning of each biennium and the *Legislative Fiscal Report* is published at the end of each session. The latter is a record of legislative actions that resulted from the enactment of House Bill 2 and other appropriation legislation, as well as revenue estimation and discussion of other fiscal issues.

- The *Legislative Budget Analysis* for all biennia beginning with the 1979 biennium is stored in the LFD office and in the State Library
- The *Legislative Fiscal Report* for all biennia beginning with the 1979 biennium is stored in the LFD office and in the State Library. Early versions of this report were titled the *Appropriations Report*

TRAINING PUBLICATIONS

Training material prepared by the LFD include the following:

- *Understanding State Finances and the Budgeting Process* (A Reference Manual for Legislators) is a helpful guide for persons wanting more detailed information concerning fiscal matters
- *HB 2 the Barbarian* (How to Make HB 2 Implement Public Policy as Determined by the Legislature) describes the intricacies of developing the general appropriations act

FISCAL POCKET GUIDES

A variety of brochures have been prepared to provide summary information concerning select topics important to legislators and other interested parties.

- | | |
|---|-------------------------------|
| • State Financial and Budgeting Structure | • Insurance Tax & License Fee |
| • General Fund Fiscal 2004 | • Individual Income Tax |
| • State Employees | • Tobacco Tax |
| • Higher Education Funding | • Video Gambling Tax |
| • Medicaid | • Cigarette Tax |
| • Montana Highway Funding | • Wine Tax |
| • Pertinent State Statistics | • Liquor Excise Tax |
| • Resource Indemnity Trust | • Beer Tax |
| • TANF (temporary assistance to needy families) | • Corporation Income Tax |
| • Montana's Tobacco Settlement | • Property Tax |
| • K-12 Education Funding | • Coal Tax |
| • Bed Tax | • Coal Trusts |

The LFD would welcome suggestions for other possible topics for pocket guides.



AGENCY BUDGET COMPARISONS BY FUND

INTRODUCTION

This section provides a comparison, by agency, of the Governor's executive budget recommendations for HB 2 as compared to the 2005 biennium. For each fund type, a table shows the comparison by agency. Also included for each fund type is a pie chart showing the amount and percent for each fund by major program area, and a bar graph that shows the percentage increase by major program area. The narrative describes the primary reasons for budget changes, by fund type.

GENERAL FUND

As defined in 17-2-102, MCA, the general fund "accounts for all financial resources except those required to be accounted for in another fund." The general fund provides funding for the general operations of state government.

In Figure 1, general fund increases by \$227.9 million, or 9.9 percent. Five agencies account for 84 percent of the increase.

- o The Department of Public Health and Human Services - \$83 million. Major increases are due to:
 - Caseload and service increases, most notably in Medicaid programs
 - A reduction in the share of Medicaid expenditures funded by the federal government
- o The Department of Revenue - \$33.9 million. This increase is due primarily to one-time initiatives by the executive to:
 - Pay off all of debt of the Integrated Revenue Information System (IRIS) - \$16 million
 - Completion of the previous revenue system (POINTS) - \$4 million
 - Development of a property tax replacement system - \$5.5 million
 - Agricultural land re-evaluation system development - \$1.4 million
- o K-12 Education - \$28.2 million. Increases are due primarily to inflationary adjustments, as well as increases in several programs, including special education, school facilities, gifted and talented, and vocational education
- o Corrections - \$24.1 million. These increases are due to:
 - Provision of contract beds and probation and parole officers to address additional populations
 - Overtime
- o Higher Education - \$22.4 million. The executive recommends two major adjustments that cause most of the increase:
 - An initiative of just under \$10 million for the Shared Leadership project, which seeks to position the Montana University System as an economic development driver, and for equipment in the vocational-technical schools
 - An increase in the percentage support of general fund for various operational cost increases in order to reduce potential tuition increases

Figure 1

General Fund Comparison
05 Biennium Versus Executive Budget 07 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2004	Adjusted Authorized Fiscal 2005	Total Exec. Budget Fiscal 2006	Total Exec. Budget Fiscal 2007	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 07 Biennium - 05 Biennium	% Change 05 Biennium
1104	Legislative Branch	\$7,055,185	\$9,051,073	\$8,360,892	\$8,395,184	\$16,106,258	\$16,756,076	\$649,818	4.03%
2110	Judicial Branch	31,031,278	27,510,035	35,910,033	34,784,110	58,541,313	70,694,143	12,152,830	20.76%
3101	Governor's Office	4,226,670	4,591,342	4,832,589	4,770,906	8,818,012	9,603,495	785,483	8.91%
3202	Commissioner Of Political Practices	309,317	323,573	329,973	317,725	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	0	0	0	0	0	0	0	
3501	Office Of Public Instruction	514,085,061	514,892,443	525,387,352	531,801,401	1,028,977,504	1,057,188,753	28,211,249	2.74%
4107	Crime Control Division	1,623,752	1,650,735	1,720,172	1,717,425	3,274,487	3,437,597	163,110	4.98%
4110	Department Of Justice	18,497,606	18,970,678	21,136,103	19,622,668	37,468,284	40,758,771	3,290,487	8.78%
5101	Board Of Public Education	141,309	163,981	167,292	165,348	305,290	332,640	27,350	8.96%
5102	Commissioner Of Higher Education	140,778,703	137,207,301	150,226,813	150,177,464	277,986,004	300,404,277	22,418,273	8.06%
5113	School For The Deaf & Blind	3,408,893	3,507,788	3,984,836	3,952,131	6,916,681	7,936,967	1,020,286	14.75%
5114	Montana Arts Council	286,250	290,354	356,356	290,905	576,604	647,261	70,657	12.25%
5115	Montana State Library	1,497,806	1,716,629	1,847,093	1,560,479	3,214,435	3,407,572	193,137	6.01%
5117	Montana Historical Society	1,715,418	1,766,280	1,943,471	1,868,562	3,481,698	3,812,033	330,335	9.49%
5301	Department Of Environmental Quality	3,053,744	3,163,556	4,129,497	4,096,940	6,217,300	8,226,437	2,009,137	32.32%
5603	Department Of Livestock	521,303	532,960	552,314	550,398	1,054,263	1,102,712	48,449	4.60%
5706	Dept Of Natural Resources & Conservation	16,825,529	17,494,723	21,586,871	21,329,824	34,320,252	42,916,695	8,596,443	25.05%
5801	Department Of Revenue	29,279,359	27,069,620	54,485,841	35,743,558	56,348,979	90,229,399	33,880,420	60.13%
6101	Department Of Administration	3,363,958	3,550,361	8,014,829	3,893,164	6,914,319	11,907,993	4,993,674	72.22%
6102	Appellate Defender	186,615	186,847	200,602	197,014	373,462	397,616	24,154	6.47%
6201	Department Of Agriculture	598,135	628,231	613,907	575,149	1,226,366	1,189,056	(37,310)	-3.04%
6401	Department Of Corrections	104,019,287	106,628,700	117,303,917	117,480,152	210,647,987	234,784,069	24,136,082	11.46%
6501	Department Of Commerce	1,565,311	1,584,025	1,625,527	1,624,909	3,149,336	3,250,436	101,100	3.21%
6602	Department Of Labor & Industry	1,155,525	1,198,407	1,826,079	1,848,340	2,353,932	3,674,419	1,320,487	56.10%
6701	Department Of Military Affairs	4,111,558	4,194,772	4,375,999	4,366,941	8,306,330	8,742,940	436,610	5.26%
6901	Dept Of Public Health & Human Services	248,448,589	272,062,610	296,181,383	307,367,803	520,511,199	603,549,186	83,037,987	15.95%
Total		\$1,137,786,161	\$1,159,937,024	\$1,267,099,741	\$1,258,498,500	\$2,297,723,185	\$2,525,598,241	\$227,875,056	9.92%

Figure 2

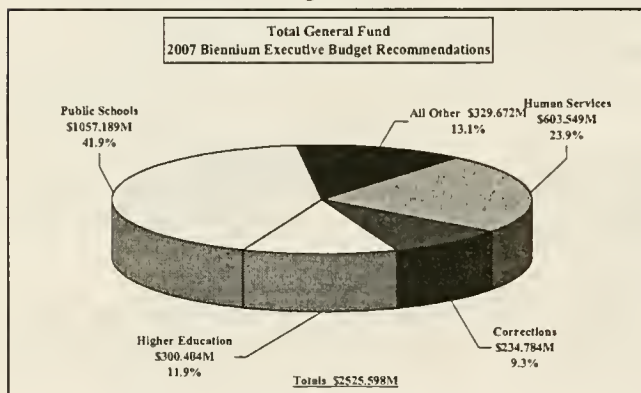
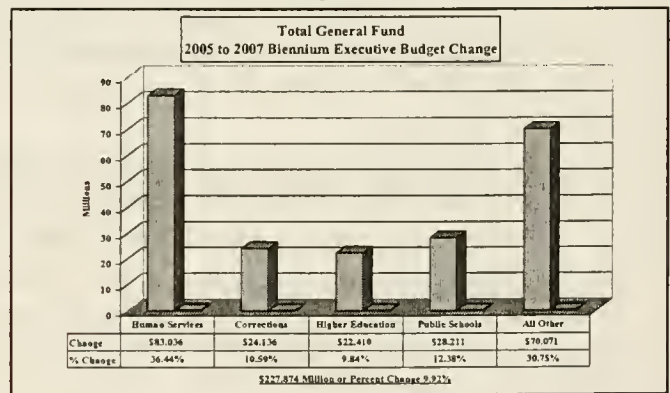


Figure 3



STATE SPECIAL REVENUE

As defined in 17-2-102, MCA, the state special fund “consists of money from state and other non-federal sources deposited in the state treasury that is earmarked for the purposes of defraying particular costs of an agency, program, or function of state government and money from other non-state or non-federal sources that is restricted by law or by the terms of an agreement, such as a contract, trust agreement, or donation.”

As shown in figure 4, state special revenue increases by \$115.0 million, or over 11.5 percent. Three agencies account for over 85 percent of this total increase: 1) the Montana Department of Transportation (MDT); 2) the Department of Public Health and Human Services (DPHHS); and 3) the Department of Environmental Quality.

- The increase in MDT of \$52 million is due to use of highways state special revenue account to match anticipated federal funds, as well as bonding revenue for the Highway 93 project
- The increase in DPHHS is \$36.8 million and is primarily due to the proposed continuance of tobacco settlement proceeds from tobacco control and prevention to fund other DPHHS programs, and of the hospital provider tax used to match federal funds for rate enhancement
- Increases in the Department of Environmental Quality of \$8.8 million are primarily due to the provision of reclamation and remediation bonding authority

Figure 4
State Special Revenue Fund Comparison
05 Biennium Versus Executive Budget 07 Biennium

Agency Code	Agency Name	Adjusted Expenditures Fiscal 2004	Adjusted Authorized Fiscal 2005	Total Exec. Budget Fiscal 2006	Total Exec. Budget Fiscal 2007	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 07 Biennium - 05 Biennium	% Change 05 Biennium 07 Biennium
1104	Legislative Branch	\$2,091,476	\$1,966,601	\$2,418,296	\$1,794,996	\$4,058,077	\$4,213,292	\$155,215	3.82%
1112	Consumer Council	1,297,083	1,348,733	1,377,516	1,390,705	2,645,816	2,768,221	122,405	4.63%
2110	Judicial Branch	2,378,886	3,563,163	1,738,300	1,094,882	5,942,049	2,833,182	(3,108,867)	-52.32%
3101	Governor's Office	45,247	10,299,338	10,016,796	161,583	10,344,585	10,178,379	(166,206)	-1.61%
3401	State Auditor's Office	4,402,828	5,027,115	5,091,540	5,120,629	9,429,943	10,212,169	782,226	8.30%
3501	Office Of Public Instruction	943,936	948,016	967,779	967,784	1,891,952	1,935,563	43,611	2.31%
4110	Department Of Justice	27,440,085	34,941,053	33,902,247	29,366,120	62,381,138	63,268,367	887,229	1.42%
4201	Public Service Regulation	2,669,538	3,246,224	2,924,244	2,763,430	5,915,762	5,687,674	(228,088)	-3.86%
5101	Board Of Public Education	152,785	191,300	193,340	191,645	344,085	384,985	40,900	11.89%
5102	Commissioner Of Higher Education	13,101,000	13,228,999	14,336,001	14,630,000	26,329,999	28,966,001	2,636,002	10.01%
5113	School For The Deaf & Blind	341,095	342,082	282,752	282,752	683,177	565,504	(117,673)	-17.22%
5114	Montana Arts Council	158,801	156,225	165,978	167,702	315,026	333,680	18,654	5.92%
5115	Montana State Library	1,020,396	1,020,824	1,048,747	1,048,748	2,041,220	2,097,495	56,275	2.76%
5117	Montana Historical Society	517,318	551,581	555,655	554,574	1,068,899	1,110,229	41,330	3.87%
5201	Department Of Fish, Wildlife & Parks	37,449,204	39,947,154	39,813,363	36,857,159	77,396,358	76,670,522	(725,836)	-0.94%
5301	Department Of Environmental Quality	17,829,392	47,871,613	55,769,689	18,750,191	65,701,005	74,519,880	8,818,875	13.42%
5401	Department Of Transportation	237,162,066	257,795,421	287,267,695	260,039,377	494,957,487	547,307,072	52,349,585	10.58%
5603	Department Of Livestock	5,627,536	7,189,943	6,071,564	6,099,685	12,817,479	12,171,249	(646,230)	-5.04%
5706	Dept Of Natural Resources & Conservatio	16,489,400	17,643,761	20,424,346	19,309,225	34,133,161	39,733,571	5,600,410	16.41%
5801	Department Of Revenue	549,014	553,163	621,921	632,330	1,102,177	1,254,251	152,074	13.80%
6101	Department Of Administration	3,715,679	4,074,101	5,714,947	5,692,831	7,789,780	11,407,778	3,617,998	46.45%
6106	Mt Consensus Council	239,800	273,341	198,367	198,181	513,141	396,548	(116,593)	-22.72%
6201	Department Of Agriculture	7,578,716	8,795,144	9,428,601	9,402,295	16,373,860	18,830,896	2,457,036	15.01%
6401	Department Of Corrections	2,084,959	2,602,923	2,687,469	2,684,418	4,687,882	5,371,887	684,005	14.59%
6501	Department Of Commerce	1,622,888	2,902,659	3,432,398	1,843,809	4,525,547	5,276,207	750,660	16.59%
6602	Department Of Labor & Industry	24,912,507	26,686,355	27,686,362	27,922,361	51,598,862	55,608,723	4,009,861	7.77%
6701	Department Of Military Affairs	542,203	1,300,645	984,976	982,700	1,842,848	1,967,676	124,828	6.77%
6901	Dept Of Public Health & Human Services	36,553,605	49,641,208	61,453,879	61,519,915	86,194,813	122,973,794	36,778,981	42.67%
Total		\$448,917,443	\$544,108,685	\$596,574,768	\$511,470,027	\$993,026,128	\$1,108,044,795	\$115,018,667	11.58%

Figure 5

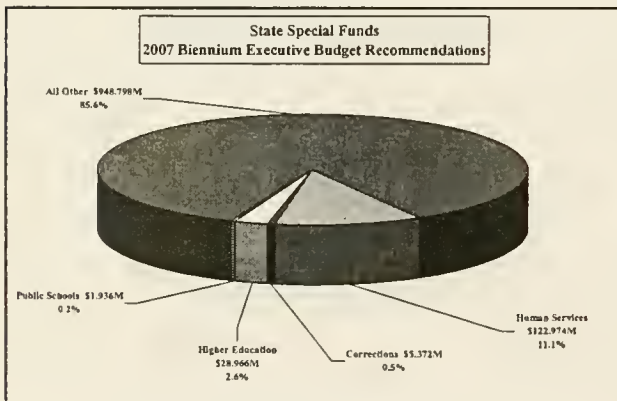
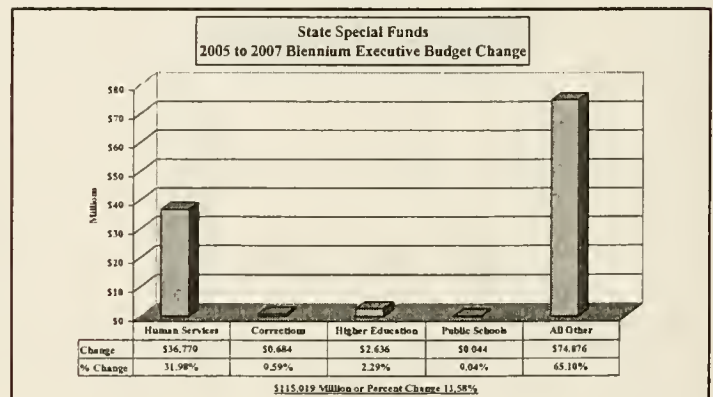


Figure 6



FEDERAL SPECIAL REVENUE

As defined in 17-2-102, MCA, the federal special fund “consists of money deposited in the treasury from federal sources, including trust income, that is used for the operation of state government.”

As shown in Figure 7, federal funds would increase \$311.8 million, or 10.8 percent, primarily due to the increases in human services, which account for \$214.4 million, or almost 69 percent of the total increase. There are a number of reasons for the increase in human services federal funds, primarily:

- Increased caseloads and services in a number of programs, most particularly in Medicaid and food stamps
- Medicaid redesign efforts, a major part of which is to use existing state resources as match to secure additional federal funds
- Continued use of bed tax and hospital utilization fees to match federal funds
- Increases in categorical federal grants

Other major increases are due to utilization of anticipated federal grant funds in:

- Highways construction
- K-12 education
- Environmental and wildlife
- Community development

Figure 7

**Federal Special Revenue Fund Comparison
05 Biennium Versus Executive Budget 07 Biennium**

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2004	Adjusted Authorized Fiscal 2005	Total Exec. Budget Fiscal 2006	Total Exec. Budget Fiscal 2007	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 07 Biennium - 05 Biennium	% Change 05 Biennium
2110	Judicial Branch	\$136,150	\$209,161	\$692,510	\$692,310	\$345,311	\$1,384,820	\$1,039,509	301.04%
3101	Governor's Office	110,377	2,110,922	114,009	113,966	2,221,299	227,975	(1,993,324)	-89.74%
3201	Secretary Of State's Office	0	0	5,469,529	5,556,936	0	11,026,465	11,026,465	
3401	State Auditor's Office	0	0	0	0	0	0	0	
3501	Office Of Public Instruction	128,186,361	150,109,721	145,037,036	152,257,932	278,296,082	297,294,968	18,998,886	6.83%
4107	Crime Control Division	8,896,110	15,412,436	13,689,910	13,689,767	24,308,546	27,379,677	3,071,131	12.63%
4110	Department Of Justice	2,786,344	3,247,260	2,863,202	2,595,992	6,033,604	5,459,194	(574,410)	-9.52%
4201	Public Service Regulation	13,732	13,980	13,732	13,732	27,712	27,464	(248)	-0.89%
5101	Board Of Public Education	0	0	0	0	0	0	0	
5102	Commissioner Of Higher Education	33,020,086	54,168,298	44,656,165	46,775,603	87,188,384	91,431,768	4,243,384	4.87%
5113	School For The Deaf & Blind	96,696	96,696	102,865	102,865	193,392	205,730	12,338	6.38%
5114	Montana Arts Council	579,984	621,587	602,734	602,734	1,201,571	1,205,468	3,897	0.32%
5115	Montana State Library	757,888	1,253,505	1,180,694	780,694	2,011,393	1,961,388	(50,005)	-2.49%
5117	Montana Historical Society	720,896	755,849	791,541	790,789	1,476,745	1,582,330	105,585	7.15%
5201	Department Of Fish, Wildlife & Parks	14,941,052	15,456,384	21,478,580	18,260,227	30,397,436	39,738,807	9,341,371	30.73%
5301	Department Of Environmental Quality	20,460,991	22,376,065	31,512,442	25,578,072	42,837,056	57,090,514	14,253,458	33.27%
5401	Department Of Transportation	253,567,401	384,540,233	328,813,657	339,834,622	638,107,634	668,648,279	30,540,645	4.79%
5603	Department Of Livestock	1,277,919	1,598,820	1,465,125	1,462,522	2,876,739	2,927,647	50,908	1.77%
5706	Dept Of Natural Resources & Conservation	1,764,840	1,863,030	1,987,962	2,001,908	3,627,870	3,989,870	362,000	9.98%
5801	Department Of Revenue	2,362,285	2,184,473	298,421	301,502	4,546,758	599,923	(3,946,835)	-86.81%
6101	Department Of Administration	1,049,961	1,966,933	1,540,521	1,539,947	3,016,894	3,080,468	63,574	2.11%
6201	Department Of Agriculture	827,084	3,312,907	5,090,103	1,494,618	4,139,991	6,584,721	2,444,730	59.05%
6401	Department Of Corrections	228,677	497,053	554,852	554,852	725,730	1,109,704	383,974	52.91%
6501	Department Of Commerce	16,498,731	13,933,825	18,097,671	18,329,596	30,432,556	36,427,267	5,994,711	19.70%
6602	Department Of Labor & Industry	33,982,053	38,253,265	36,620,200	36,421,394	72,235,318	73,041,594	806,276	1.12%
6701	Department Of Military Affairs	10,346,421	13,147,135	12,367,232	12,398,731	23,493,556	24,765,963	1,272,407	5.42%
6901	Dept Of Public Health & Human Services	782,469,861	845,624,148	893,509,706	948,971,687	1,628,094,009	1,842,481,393	214,387,384	13.17%
Total		\$1,315,081,900	\$1,572,753,686	\$1,568,550,399	\$1,631,122,998	\$2,887,835,586	\$3,199,673,397	\$311,837,811	10.80%

Figure 8

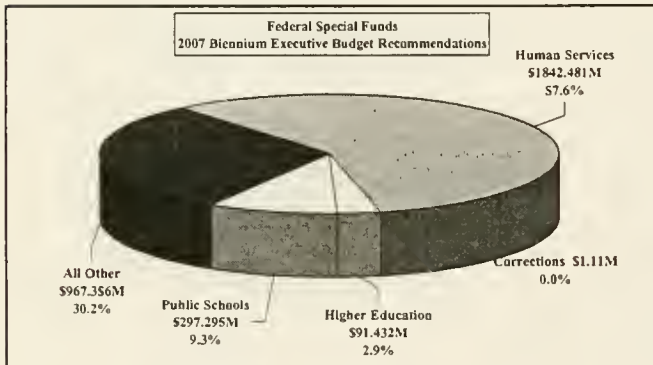
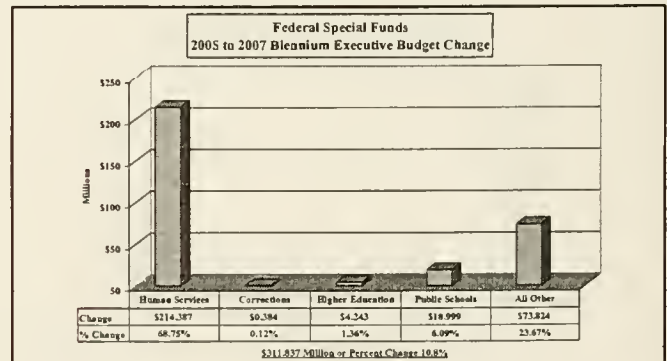


Figure 9



PROPRIETARY FUNDS

As defined in 17-7-102, MCA, proprietary funds are designated as either enterprise or internal service funds. Enterprise funds "account for operations: (A) that are financed and operated in a manner similar to private business enterprises whenever the intent of the legislature is that costs (i.e. expenses, including depreciation) of providing goods or services to that general public on a continuing basis are to be financed or recovered primarily through user charges; or (B) whenever the legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes." Internal service funds "account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost reimbursed basis."

Statute does not require that most proprietary funds be appropriated. Therefore, any increases in the programs supported with these proprietary funds are not reflected in the table.

As shown in Figure 10, appropriated proprietary funds decrease almost \$70,000 or 0.3 percent, due primarily to the net of various increases and decreases, of which one is in the Department of Labor and Industry that actually represents a error in mapping expenditures from what should have been a non-budgeted account to a HB 2 account.

Figure 10

Proprietary Fund Comparison 05 Biennium Versus Executive Budget 07 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2004	Adjusted Authorized Fiscal 2005	Total Exec. Budget Fiscal 2006	Total Exec. Budget Fiscal 2007	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 07 Biennium - 05 Biennium	% Change 05 Biennium 07 Biennium
4110	Department of Justice	\$810,037	\$821,848	\$1,010,326	\$897,056	\$1,631,885	\$1,907,382	\$275,497	16.88%
5117	Historical Society	828,812	875,378	959,014	950,583	1,704,190	1,909,597	205,407	12.05%
5801	Department of Revenue	2,003,783	1,983,452	2,115,429	2,114,174	3,987,235	4,229,603	242,368	6.08%
6101	Department of Administration	8,404,704	7,420,334	8,221,454	7,496,256	15,825,038	15,717,710	(107,328)	-0.68%
6201	MT Dept of Agriculture	285,518	328,770	367,277	369,592	614,288	736,869	122,581	19.95%
6401	Dept of Corrections	462,573	549,311	487,797	481,654	1,011,884	969,451	(42,433)	-4.19%
6602	Labor & Industry	<u>61,045</u>	<u>864,255</u>	<u>80,207</u>	<u>79,348</u>	<u>925,300</u>	<u>159,555</u>	<u>(765,745)</u>	<u>-82.76%</u>
Total		\$12,856,472	\$12,843,348	\$13,241,504	\$12,388,663	\$25,699,820	\$25,630,167	(\$69,653)	-0.27%

ALL FUNDS

Figure 11 is a composite by agency of the preceding tables, and shows an \$654.6 million, or 10.6 percent increase in total fund expenditures.

Figure 11					
All Funds Comparison					
05 Biennium Versus Executive Budget 07 Biennium					
Agcy		Total	Total	Difference	% Change
Code	Agency Name	Adjusted	Exec. Budget	07 Biennium	05 Biennium
		Fiscal 04-05	Fiscal 06-07	- 05 Biennium	07 Biennium
1104	Legislative Branch	\$20,164,335	\$20,969,368	\$805,033	3.99%
1112	Consumer Council	2,645,816	2,768,221	122,405	4.63%
2110	Judicial Branch	64,828,673	74,912,145	10,083,472	15.55%
3101	Governor's Office	21,383,896	20,009,849	(1,374,047)	-6.43%
3201	Secretary Of State's Office	0	11,026,465	11,026,465	
3202	Commissioner Of Political Practices	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	9,429,943	10,212,169	782,226	8.30%
3501	Office Of Public Instruction	1,309,165,538	1,356,419,284	47,253,746	3.61%
4107	Crime Control Division	27,583,033	30,817,274	3,234,241	11.73%
4110	Department Of Justice	107,514,911	111,393,714	3,878,803	3.61%
4201	Public Service Regulation	5,943,474	5,715,138	(228,336)	-3.84%
5101	Board Of Public Education	649,375	717,625	68,250	10.51%
5102	Commissioner Of Higher Education	391,504,387	420,802,046	29,297,659	7.48%
5113	School For The Deaf & Blind	7,793,250	8,708,201	914,951	11.74%
5114	Montana Arts Council	2,093,201	2,186,409	93,208	4.45%
5115	Montana State Library	7,267,048	7,466,455	199,407	2.74%
5117	Montana Historical Society	7,731,532	8,414,189	682,657	8.83%
5201	Department Of Fish, Wildlife & Parks	107,793,794	116,409,329	8,615,535	7.99%
5301	Department Of Environmental Quality	114,755,361	139,836,831	25,081,470	21.86%
5401	Department Of Transportation	1,133,065,121	1,215,955,351	82,890,230	7.32%
5603	Department Of Livestock	16,748,481	16,201,608	(546,873)	-3.27%
5706	Dept Of Natural Resources & Conservation	72,081,283	86,640,136	14,558,853	20.20%
5801	Department Of Revenue	65,985,149	96,313,176	30,328,027	45.96%
6101	Department Of Administration	34,575,942	43,113,949	8,538,007	24.69%
6102	Appellate Defender	373,462	397,616	24,154	6.47%
6106	Mt Consensus Council	513,141	396,548	(116,593)	-22.72%
6201	Department Of Agriculture	22,354,505	27,341,542	4,987,037	22.31%
6401	Department Of Corrections	217,073,483	242,235,111	25,161,628	11.59%
6501	Department Of Commerce	38,107,439	44,953,910	6,846,471	17.97%
6602	Department Of Labor & Industry	127,113,412	132,484,291	5,370,879	4.23%
6701	Department Of Military Affairs	33,642,734	35,476,579	1,833,845	5.45%
6901	Dept Of Public Health & Human Services	<u>2,234,800,021</u>	<u>2,569,004,373</u>	<u>334,204,352</u>	<u>14.95%</u>
Total		\$6,205,314,630	\$6,859,946,600	\$654,631,970	10.55%



TRUST FUNDS

BACKGROUND

Montana has a number of constitutional and statutory trusts that provide interest income (over \$85 million per year) to fund state government operations. While recent legislatures eliminated the principal of the education trust, slowed the flow of revenue into the coal tax trust and parks acquisition trust, and capped the growth of the resource indemnity tax trust, substantial balances totaling over \$1.3 billion at the end of FY 2004 remain.

1999 LEGISLATURE

The Fifty-sixth Legislature in the 1999 session reduced the rate of growth in many of the trusts by passing legislation that redirected incoming revenues. The Fifty-sixth Legislature passed legislation that reduced the FY 2001 ending fund balance for all trusts combined by an estimated \$26 million when compared with pre-session estimates. The reduction in revenue growth was the greatest for the Permanent Coal Tax Trust, the Treasure State Endowment, and the Common School Fund. The legislature substantially enhanced the revenue growth into the noxious weed trust and marginally increased revenue into the Resource Indemnity Trust.

2001 LEGISLATURE

The Fifty-seventh Legislature in the 2001 session enacted several measures impacting state trust funds.

- HB 444 appropriated to the Department of Justice \$990,000 for the 2003 biennium as a loan from the coal severance permanent fund. The purpose of the appropriation was to conduct the natural resource damage assessment and litigation and to pursue Montana's remaining natural resource damage claims, including any appeals, against the Atlantic Richfield Company. This results in a loss of trust interest earning transfers to the general fund.
- HB 610, beginning FY 2004, reduces the amount of total coal severance tax collections deposited in the treasure state endowment fund from 37.5 percent to percent 25.0 percent and increases the amount deposited to the permanent fund from 0 percent to 12.5 percent.
- The passage of SB 495 resulted in the sale of the common school trust's mineral production rights and the diversion of future royalties that would have been deposited in the trust. As a result of the sale, the balance of the common school trust increased by \$46.4 million, but the trade-off was a substantial future reduction in future growth of the trust. For further information and analysis of SB 495, contact the Legislative Fiscal Division for a copy of the two-part report: "SB 495 – Implementation, Impacts and Implications".
- Because the resource indemnity trust reached the constitutionally protected cap of \$100 million in FY 2002, any amount in excess of \$100 million becomes available for the legislature to appropriate. In HB 2, the legislature appropriated all of the estimated \$1.1 million excess in FY 2003, thus reducing the trust balance.

2003 LEGISLATURE

The Fifty-eighth Legislature in the 2003 session enacted one measure impacting state trust funds. HB 160 appropriated to the Department of Justice \$650,000 for the 2005 biennium as a loan from the coal severance permanent fund. The purpose of the appropriation is to conduct the natural resource damage assessment and litigation and to pursue Montana's remaining natural resource damage claims, including any appeals, against the Atlantic Richfield Company. The resulting loss in transfer of trust interest earnings to the general fund is expected to be \$21,807 in FY 2004 and \$44,135 in FY 2005.

MAJOR TRUST FUNDS

OVERVIEW

Figures 1 and 2 show the history of the ten major trusts since FY 1973. Forecast amounts are shown for FY 2005, 2006 and 2007, and are based on assumptions contained in HJR 2 (HJR2). Following is a description of each trust and the income it generates. Also shown are expected interest earnings from each trust in FY 2005, 2006, and 2007.

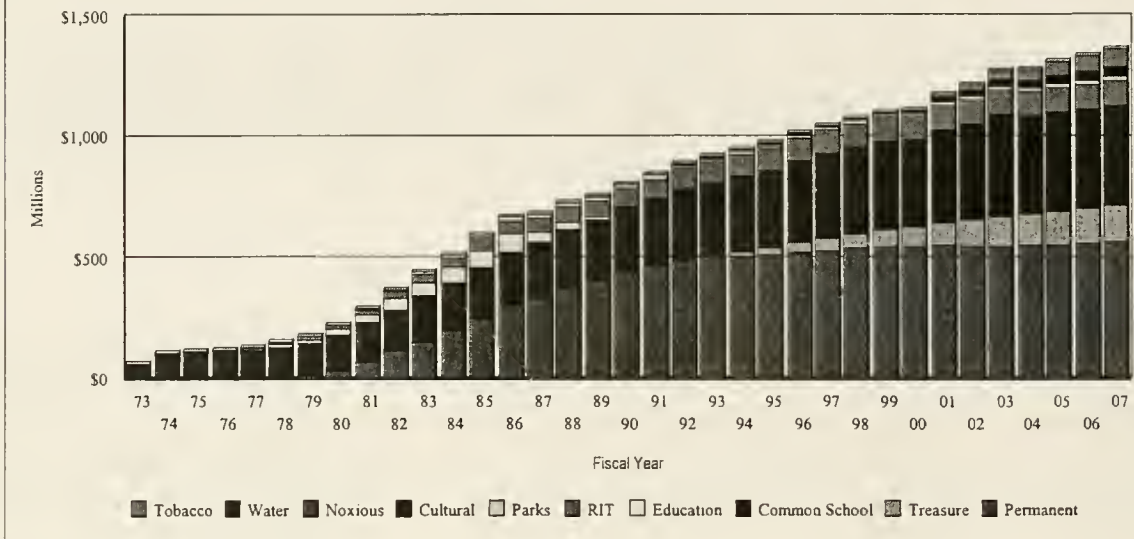
Figure 1

Selected Trust Fund Balances
Including Projected Investment Earnings

Fiscal Year	Permanent Coal Tax Trust Fund	Treasure St Endowment Trust Fund	Common * School Trust Fund	Education Trust Fund	Resource Indemnity Trust Fund	Parks * Acquisition Trust Fund	Cultural * Protection Trust Fund	Noxious * Weed Trust Fund	Regional Water Trust Fund	Tobacco Trust Fund	Total Trust Funds
A 73	0	0	\$64,223,773	0	0	0	0	0	0	0	\$64,223,773
A 74	0	0	108,998,870	0	\$1,141,385	0	0	0	0	0	110,140,255
A 75	0	0	113,064,188	0	3,287,456	0	0	0	0	0	116,351,644
A 76	0	0	117,849,628	\$2,227,793	5,552,291	\$278,725	0	0	0	0	125,908,437
A 77	0	0	123,281,528	6,039,530	8,232,247	758,308	0	0	0	0	138,311,613
A 78	\$6,268,262	0	129,949,247	8,983,763	10,646,851	1,174,356	0	0	0	0	157,022,479
A 79	16,940,538	0	137,716,735	12,339,549	12,574,209	1,475,732	0	0	0	0	181,046,763
A 80	39,964,765	0	147,527,943	23,905,146	16,204,531	3,565,371	0	0	0	0	231,167,756
A 81	75,187,459	0	163,163,556	33,624,170	21,165,464	5,325,746	0	0	0	0	298,466,395
A 82	118,336,314	0	176,467,865	44,338,477	28,328,946	7,480,418	0	0	0	0	374,952,020
A 83	158,358,806	0	189,390,417	52,665,410	36,181,889	9,481,542	0	0	0	0	446,078,064
A 84	202,936,358	0	201,319,109	60,925,268	42,986,128	11,565,460	0	0	0	0	519,732,323
A 85	252,420,524	0	214,764,544	70,500,922	47,396,179	13,859,181	0	0	0	0	598,941,350
A 86	309,384,250	0	217,677,906	79,761,708	53,039,675	16,222,131	0	\$443,184	0	0	676,528,854
A 87	339,883,180	0	227,687,073	44,091,429	56,861,627	16,613,608	0	824,550	0	0	685,961,467
A 88	381,180,287	0	239,553,633	33,671,110	61,750,961	16,581,042	0	1,070,972	0	0	733,808,005
A 89	411,838,993	0	254,128,428	8,651,477	66,665,000	16,608,706	0	1,320,720	0	0	759,213,324
A 90	446,511,416	0	268,496,362	0	72,811,618	17,936,701	0	1,688,370	0	0	807,444,467
A 91	470,322,655	0	280,326,496	0	77,324,921	18,882,548	0	2,121,973	0	0	848,978,593
A 92	496,465,569	0	291,753,603	0	82,489,898	12,588,366	\$7,051,506	2,584,254	0	0	892,933,196
A 93	511,474,640	0	300,782,863	0	86,890,369	12,538,119	6,863,579	2,534,844	0	0	921,084,414
A 94	511,754,471	\$20,520,830	310,735,129	0	89,316,268	12,538,119	7,025,290	2,518,875	0	0	954,408,982
A 95	515,470,287	31,793,125	321,265,835	0	91,614,674	12,538,119	7,296,373	2,544,390	0	0	982,522,803
A 96	530,144,251	42,262,548	331,630,225	0	93,152,864	12,998,633	7,518,157	2,502,197	0	0	1,020,208,875
A 97	538,223,210	52,210,048	347,298,490	0	94,584,643	13,483,000	3,846,000	2,527,953	0	0	1,052,173,344
A 98	545,789,038	61,800,580	355,329,490	0	95,582,249	14,005,728	3,852,201	2,537,621	0	0	1,078,896,907
A 99	555,204,609	68,334,808	365,188,709	0	94,991,658	14,399,076	3,852,202	2,471,388	0	0	1,104,442,450
A 00	553,031,020	81,347,120	359,661,156	0	96,404,163	14,834,592	4,050,384	3,635,000	\$3,441,977	0	1,116,405,412
A 01	557,477,352	92,182,012	384,741,584	0	100,373,547	15,376,300	4,257,671	4,760,000	7,389,930	\$10,819,202	1,177,377,598
A 02	555,718,038	105,383,384	394,132,998	0	102,065,653	15,777,802	4,454,360	4,760,000	11,914,241	23,203,088	1,217,409,564
A 03	553,406,844	120,337,392	424,415,537	0	100,000,965	15,777,996	4,454,456	5,073,619	16,902,479	35,830,328	1,276,199,616
A 04	557,754,322	128,083,371	405,618,690	0	100,002,390	16,289,556	4,653,188	4,864,635	21,078,919	46,788,330	1,285,133,401
Fund Balance Forecast											
F 05	561,735,000	136,391,000	408,946,000	0	100,254,844	16,712,000	4,862,000	4,864,635	25,233,000	57,542,000	1,316,540,479
F 06	565,685,000	144,292,000	410,613,000	0	100,254,844	17,113,000	5,061,000	4,864,635	29,183,000	66,347,000	1,343,413,479
F 07	569,719,000	152,013,000	412,280,000	0	100,254,844	17,523,000	5,264,000	4,864,635	33,044,000	75,165,000	1,370,127,479
Investment Earnings Forecast											
F 05	35,999,000	9,094,000	26,807,000	0	7,401,000	1,163,000	338,000	253,118	1,487,000	3,123,000	85,670,682
F 06	36,790,000	9,704,000	27,019,000	0	7,417,000	1,191,000	351,000	253,118	1,757,000	3,709,000	88,196,682
F 07	37,244,000	10,230,000	27,139,000	0	7,420,000	1,217,000	364,000	253,118	2,007,000	4,230,000	90,109,682

* These trust fund balances include trust fund bond pool appreciation/depreciation entries.

Figure 2
Cumulative Balances of Trust Funds



**LFD
COMMENT**

Various restrictions, either constitutional or statutory, prohibit or restrict the expenditure of all or a portion of trust fund balances. For example, the Montana Constitution prohibits expenditure of money in the resource indemnity tax trust until the balance reaches \$100 million. Since the balance of this trust is at this limit, any additional trust balance can be spent. Figure 3 shows the nine trust funds, their fiscal 2004 balances, and the restrictions for spending the balances.

Figure 3
Selected Trust Funds
Balances and Restrictions

Type of Restriction/Trust Fund	Fiscal 2004 Balance	Restrictions
Statutory		
Parks Acquisition Trust	\$16,289,556	None
Cultural Trust	4,653,188	None
Subtotal	\$20,942,744	
Constitutional		
Permanent Coal Severance Tax Trust	\$557,754,322	Inviolate, except by 3/4 vote of each house
Common School Trust	405,618,690	Inviolate, guaranteed by state against loss or diversion
Treasure State Endowment Trust	128,083,371	Inviolate except by 3/4 vote of each house
Resource Indemnity Tax Trust	100,002,390	Inviolate, \$100 million guaranteed by state against loss or diversion
Tobacco Settlement Trust	46,788,330	Inviolate, except by 2/3 vote of each house
TSE Regional Water System Trust	21,078,919	Inviolate, except by 3/4 vote of each house
Noxious Weed Management	4,864,635	\$10 million inviolate, except by 3/4 vote of each house *
Subtotal	\$1,264,190,657	
Total	\$1,285,133,401	

* If the statutory noxious weed management trust is designated by the legislature to be the constitutional trust.

CONSTITUTIONAL TRUSTS

Permanent Coal Tax Trust

Article IX, Section 5 of the Montana Constitution requires that at least 50 percent of all coal severance tax revenue be deposited in a permanent coal tax trust fund, and that the principal of the trust "shall forever remain inviolate unless appropriated by a vote of three-fourths of the members of each house of the legislature." By statute, interest earned on this trust that is not earmarked for other programs is distributed 100 percent to the general fund. As described below, some of the interest earned on the trust is earmarked for other programs.

The interest earned on the permanent coal tax trust fund is an important general fund revenue source. During the period of FY 1981 through FY 2004, \$821.9 million in interest from this trust was deposited in the combined general fund/school equalization account (SEA). In FY 2004, permanent coal tax trust fund interest provided 2.5 percent of total revenue to the general fund.

Initiative 95, approved by voters in 1982, required that 25 percent of the revenue deposited in the permanent coal tax trust after June 30, 1983, be placed in the in-state investment trust fund for investment in the Montana economy "with special emphasis on investments in new or expanding locally owned enterprises." The 1991 legislature: 1) eliminated separate accounting for the in-state investment trust; and 2) instructed the Board of Investments to "endeavor to invest up to 25 percent of the permanent coal tax trust fund" in the Montana economy.

The 1989 and 1991 legislatures gave authority to the Montana Science and Technology Alliance (MSTA) for the use of \$12.5 million from the in-state investment fund for investment in new and expanding technology-based Montana businesses and for research and development project loans. The 1993 legislature authorized MSTTA to invest an additional \$11.0 million from the in-state investment program.

The payback of principal from MSTTA loans returns to the trust. Before July 1, 1993, the interest from MSTTA loans was distributed in the same manner as other interest earned on the permanent coal tax trust fund. HB 394, enacted by the 1993 legislature, created a special revenue account into which all interest earned from MSTTA loans is deposited and from which MSTTA expenses will be paid, with the balance returning to the trust.

The 1991 legislature also appropriated \$3.3 million from the permanent coal tax trust fund for the Microbusiness Development Act. These funds provided capital to microbusiness development corporations that provide loans and technical assistance to qualified small businesses. Interest earnings and loan repayments were retained by the program to finance administrative costs and future loans.

During the January 1992 special session, the legislature authorized the creation of a school bond contingency loan fund within the permanent coal tax trust fund. The contingency fund provided up to \$25.0 million in loan guarantees for school district bonds certified by the Department of Administration as meeting certification standards, but for which subsequent litigation prevents collection of property taxes levied for debt service. School districts are required to repay any guarantee funds used. Interest on the contingency fund is distributed in the same manner as all other interest earned on the

permanent coal tax trust fund. The provisions of this legislation expired on January 1, 1993. HB 667, passed during the 1993 legislative session, provides Guaranteed Tax Base (GTB) aid to certain schools with bonds outstanding or bond issues contemplated. The source of funding for GTB aid was the school equalization account (SEA). The contingency fund will continue to exist until calendar 2012 when the bonds will be retired. At the end of FY 2003, all schools districts with loans backed by the state had refinanced their debt and the state no longer secures the bonds issued by the Department of Administration. In FY 2003, all reserves in the contingency fund were distributed to the treasure state endowment fund and the treasure state endowment regional water fund.

In the June 1992 election, voters approved a referendum to create the treasure state endowment fund (TSEF) within the permanent coal tax trust fund. The fund received a \$10.0 million grant from the trust principal in FY 1994 and will receive half the funds deposited in the trust during FY 1995 through FY 2013. Interest earned on the TSEF is used to finance local infrastructure projects, as prioritized by the Departments of Commerce and Natural Resources and Conservation, and authorized by the legislature.

During the November 1993 special session, the legislature authorized SB 4 that required the cash balance in the coal tax bond fund as of July 1, 1993 be deposited in the permanent coal tax trust fund. The total amount transferred was \$31.1 million. SB 4 also changed the distribution mechanism by requiring the 50 percent coal severance tax revenue allocation be deposited in the TSEF and the permanent coal tax trust fund on an equal basis. Prior to SB 4, coal severance tax revenue earned on production taking place beginning July 1, 1993, was to have been deposited in TSEF. In the following fiscal year, one-half of the previous year's inflow was to have been deposited in the permanent coal tax trust fund, and the TSEF was to retain the rest. Without SB 4, the permanent coal tax trust fund would not have received any coal severance tax revenue during FY 1994.

The 1993 legislature passed HB 401, which authorized a loan to the Department of Environmental Quality (DEQ) from the permanent coal tax trust fund for technical, litigation, and administrative expenses associated with the natural resource damage litigation suit against the Atlantic Richfield Company in the Clark Fork River Basin. The amount of the loan was \$2.6 million for the 1995 biennium and \$5.2 million to repay principal and interest to the general fund for litigation costs incurred in the 1993 biennium. As of December 1994, \$6.3 million had been withdrawn from the permanent coal tax trust to pay for litigation expenses. Since then, the case has been settled and money returned to the permanent trust (see the write-up of HB 110 enacted by the 1997 legislature).

1995 Legislative Action

HB 305 authorized a loan to the Department of Justice from the permanent coal tax trust for the purpose of conducting the litigation and natural resource claims against the Atlantic Richfield Company in the Clark Fork River Basin. The amount of the loan was \$2.4 million for the 1997 biennium. The bill also extended loans made for the same purpose during the 1995 biennium.

HB 354 expanded appropriations for the Microbusiness Financing Act, which provides loans to businesses employing less than ten employees and generating less than \$500,000 in gross revenue annually. The expansion of this program doubled the previous appropriation to \$3.25 million of investable coal tax trust funds made available to the Microbusiness Finance Program in the Department of Commerce. Beginning July 1, 1995, HB 354 also increased maximum loan amounts per individual loan from \$20,000 to \$35,000. The program provides financing for working capital assets and fixed

asset acquisition, with more flexible repayment terms than those offered by commercial institutions. Payback of interest and principal of the loan amounts are used for administrative purposes and for financing new microbusiness loans.

SB 38 authorized the Job Investment Act under which the Department of Commerce may loan a portion of the permanent coal tax trust to businesses to create and retain jobs in Montana. A loan to a qualified business may not exceed \$500,000, and the department is to report annually to the Revenue and Taxation Committee. The legislation also reduced the amount of permanent coal tax trust funds that the Board of Investments allows the Montana Board of Science and Technology Development to invest in seed capital loans and mezzanine loans from \$15.5 million to \$12.5 million. The bill also increased the amount of permanent coal tax trust funds available for research and development projects from \$8.1 million to \$11.1 million. In the past, these funds were used primarily as loans to the University System. Under SB 38, these funds were granted to the University System for research and development projects.

SB 83 abolished the distribution of coal trust interest to the SEA. Under previous law, 15 percent of coal trust interest earnings were deposited in the SEA and 85 percent in the general fund. As a result of SB 83, 100 percent of coal trust interest earnings are deposited in the general fund in FY 1996 and beyond.

1997 Legislative Action

HB 110 appropriated to the Department of Justice \$2.5 million in state special revenue to be used for continuing litigation expenses associated with the Atlantic Richfield case. The appropriation was for expenses incurred during the 1999 biennium, and, upon settlement of the case, the amount used plus interest was to be returned to the general fund. The case was settled in June of 1998 for \$215 million. On June 24, 1998, \$15 million was deposited into Short-Term Investment Pool (STIP) for payment to the permanent trust and the general fund. In the middle of October 1998, \$12.2 million was transferred to the permanent trust, including \$9.8 million in principal and \$2.4 million in interest. In the middle of November 1998, \$1.9 million was transferred to the general fund. This transfer consisted of principal (\$1.4 million) and interest (\$0.5 million), and constituted repayment of general fund loans going back to FY 1983 when the case began.

The legislature amended the allocation of coal severance taxes under 15-35-108, MCA. In HB 14, the 1997 legislature authorized the issuance of general obligation bonds to fund the purchase of Virginia City and Nevada City properties. In HB 5, the legislature allocated 1.3 percent of coal severance tax revenue to pay the debt service on the bonds, which have a term of ten years. Coal tax revenue will be distributed to the Long-Range Building Program (LRBP) debt service account for FY 1998 through 2007. This allocation diverts coal severance tax revenue that would otherwise be deposited in the general fund. Based on revenue estimates in HJR 2, this change in allocation resulted in a loss to the general fund of \$0.5 million in FY 1998 and 1999. Once the ten-year period has expired, the 1.3 percent allocation will revert to the general fund.

HB 5 also eliminated the 0.63 percent distribution of coal severance tax to the cultural and aesthetic (C&A) trust during the 1999 biennium only. The legislature appropriated \$3.9 million from the cultural trust for the immediate purchase of Virginia City and Nevada City. This appropriation resulted in a loss of trust interest revenue that otherwise would have been used to fund C&A projects during the 1999 biennium. In order to compensate for the lost interest, the legislature allocated 0.87 percent of coal

severance tax revenue to the C&A projects account and eliminated the 0.63 percent of coal severance tax revenue that had been deposited in the cultural trust. The remaining 0.24 percent of coal taxes allocated to the C&A project account was previously part of the flow into the general fund. Based on revenue estimates in HJR 2, this part of HB 5 resulted in a loss to the general fund of \$91,736 and \$93,195 for FY 1998 and 1999, respectively. After the 1999 biennium, similar amounts of coal severance tax revenue were diverted from the C&A projects account and again flowed to the general fund.

HB 578 abolished the Montana Board of Science and Technology beginning July 1, 1999. The amount of money committed for research and development (\$11.1 million) and for seed capital loans (\$12.5 million) was disbursed until July 1, 1999. Any money under these caps that had not been committed, except for \$915,000, was returned to the coal tax trust. The board continued to provide seed capital loans of up to \$700,000 to existing seed capital companies until July 1, 1999 or until an amount of \$915,000 was reached. However, up to \$75,000 could have been used for administrative expenses. Beginning April 1, 1997, the proceeds from seed capital loans must be deposited in the coal tax trust. However, during FY 1998, \$250,000 of seed capital income, as well as \$150,000 of job investment loan income, was used to fund the judges' retirement system. Also beginning April 1, 1997, and ending July 1, 1999, up to \$2.0 million in income and interest from research and development loans at Montana public universities was authorized to be granted to research and development (R&D) projects at the universities. After July 1, 1999, all repayment proceeds from both seed capital loans and R&D loans in excess of \$4.4 million must be deposited in the coal severance tax permanent fund.

1999 Legislative Action

Beginning July 1, 1999, HB 260 imposed a new coal license tax on the contract sales price of coal and reduced the coal severance tax liability for coal producers by allowing a credit against the coal severance tax in the amount of 101.5 percent of the coal license tax liability. Thus, coal producers would realize a reduction of 1.5 percent in the tax liability on coal production. The total reduction in coal severance tax collections was estimated at \$20.7 million in FY 2000 and \$19.6 million in FY 2001. The new coal license tax was estimated to generate \$20.4 million in FY 2000 and \$19.3 million in FY 2001. The legislation, in combination with HB 69 and SB 220, provided a new distribution of coal severance taxes and specified a distribution for the new coal license tax. Under the new distribution, none of the coal severance revenue would have been distributed to the permanent trust. Instead, 37.5 percent of the reduced coal severance tax revenue stream would have been deposited in the treasure state endowment trust fund, and 12.5 percent would have been deposited in a new TSEF regional water system account (SB220). The remaining distribution of the coal severance tax would be deposited as under previous law, except that the amount (1.3 percent) to long range building program debt service would have been directly deposited in the general fund as per HB 69. Coal severance tax revenue deposited in the permanent fund would be reduced by \$8.3 million in FY 2000 and by \$7.9 million in FY 2001. None of the new coal license tax would have been allocated to the permanent fund. Coal severance tax revenue deposited in the TSEF would have been reduced by \$3.6 million in FY 2000 and \$3.4 million in FY 2001. The revenue diversions in the each trust, as well as some of the revenue from the new coal license tax, would have been deposited into spendable accounts used for ongoing projects and payments associated with infrastructure loans and grants, agricultural seed capital, and research and commercialization loans and grants.

However, on January 20, 2000, the Montana Supreme Court found that HB 260 violated Article IX, Section 5, of the Montana Constitution and enjoined enforcement of the new coal producer's license

tax. This rendered most of the legislation and appropriations meaningless. The decision did not affect the establishment of the research and commercialization expendable trust. Coordination with SB 220 also was not affected, allowing the establishment of the treasure state endowment regional water system trust and the distribution of coal severance tax to the trust, and the TSEF remain intact.

HB 69 eliminated the distribution of coal severance tax revenue to the long range building debt service account that was used to pay bonds issued for the purchase of Virginia City and Nevada City properties. Beginning July 1, 1999, the revenue is deposited in the general fund and the bond service payments are made by the general fund.

Beginning July 1, 1999, SB 220 created a new treasure state endowment regional water system fund into which is deposited 25 percent of one-half of all coal severance receipts. The other 75 percent of one-half of coal severance receipts flows into TSEF.

2001 Legislative Action

The Fifty-seventh Legislature in the 2001 session enacted HB 444 that appropriated \$990,000 for the 2003 biennium to the Department of Justice as a loan from the coal severance permanent fund. The purpose of the appropriation is to conduct the natural resource damage assessment and litigation, and to pursue Montana's remaining natural resource damage claims, and any appeals against the Atlantic Richfield Company. The resulting loss in transfers of trust interest earnings to the general fund was an estimated \$17,573 in FY 2002 and \$52,718 in FY 2003. Any reimbursements received had to be deposited in the coal severance tax permanent fund. The legislation required a three-quarters vote of each house of the legislature.

Beginning FY 2004, HB 610 reduced the amount of total coal severance tax collections deposited in the treasure state endowment fund from 37.5 percent to percent 25.0 percent, and increased the amount of total collections deposited to the permanent fund from 0 percent to 12.5 percent. These changes result in greater interest earnings for the general fund and lower interest earnings for Treasure State Endowment Program beginning FY 2004.

In conjunction with HB 41, SB 495 changes the portion of school funding provided by the common school trust. The main points of the legislation are:

- Interest and income from the common school trust are deposited to a subfund of the general fund called the guarantee account
- The Department of Natural Resources and Conservation is authorized to purchase the mineral production rights from the common school trust
- A loan of up to \$75 million from the coal severance trust permanent fund will be used to purchase the mineral production rights and deposited in the common school trust (the actual transaction was \$46.4 million)
- Any mineral royalties from the purchased rights are deposited to the guarantee account
- After principal and interest payments on the loan used to purchase the mineral production rights are paid, the remaining money in the guarantee account is available for distribution to school districts
- Upon electorate approval of a constitutional amendment (contained in SB 493), the public school trust may be invested in private corporate capital stock

Although it was estimated that the cost of the mineral production rights would be \$37.4 million, the

actual amount loaned from the coal severance permanent fund was \$46.4 million. It is estimated that the loss of interest earnings that would have been deposited to the general fund is \$3.2 million in each year of the 2005 biennium. The legislation required a three-quarters vote of each house of the legislature.

Coal tax revenue flowing into the permanent coal tax trust fund is also used to secure state bonds issued to finance water resource development projects and activities.

Coal tax revenue is first deposited into the school bond contingency loan fund within the permanent coal tax trust fund. The contingency fund provides up to \$25.0 million in loan guarantees for school district bonds certified by the Department of Administration as meeting certification standards, but for which subsequent litigation prevents collection of property taxes levied for debt service. The contingency fund has provided backing for \$24.6 million in school bonds for 16 schools. The average balance in the contingency fund has been slightly more than \$2.0 million. At the end of FY 2003, all schools districts with loans backed by the state had refinance their debt and the state no longer secures the bonds issued by the Department of Administration. In FY 2003, all reserves in the contingency fund were distributed to the treasure state endowment fund and the treasure state endowment regional water fund.

In the August 2002 special legislative session the legislature passed HB 4 and HB 7. Combined, these bills changed the guarantee account from a subfund in the general fund to a state special revenue fund and statutorily appropriated the money for schools.

2003 Legislative Action

HB 160 appropriated \$650,000 to the Department of Justice for the 2005 biennium as a loan from the coal severance permanent fund. The purpose of the appropriation is to conduct the natural resource damage assessment and litigation and to pursue Montana's remaining natural resource damage claims, including any appeals, against the Atlantic Richfield Company. The resulting loss in transfers of trust interest earnings to the general fund is expected to be \$21,807 in FY 2004 and \$44,135 in FY 2005. Any reimbursements received must be deposited in the coal severance tax permanent fund. The legislation required a three-quarters vote of each house of the legislature.

Common School Trust

Article X, Sections 2 and 3 of the Montana Constitution require that all royalties and other proceeds received from school lands granted to the state under the federal enabling act must be deposited in the common school trust fund and "shall forever remain inviolate, guaranteed by the state against loss or diversion." Article X, Section 5 requires that 95 percent of the interest from this trust be used for school equalization, with the remaining 5 percent reinvested in the trust. In addition, 95 percent of all rents, royalties, and other income received from leasing of school lands is to be used for public schools with the remaining 5 percent invested in the trust.

During the January 1992 special session, the legislature passed HB 3, which provided that 95 percent of the revenue from state timber sales (approximately \$4.9 million) be deposited in the SEA during the 1993 biennium, with the remaining 5 percent deposited in the trust.

The 1993 legislature passed HB 652, which continued the practice of diverting 95 percent of timber revenue to the SEA during the 1995 biennium. The loss in revenue to the common school trust during

the 1995 biennium was approximately \$9.1 million. HB 667, also passed during the 1993 legislative session, continued this practice indefinitely. The loss of revenue to the common school trust during the 1997 biennium was approximately \$9.7 million.

1995 Legislative Action

HB 50 made permanent certain provisions regarding the sale of timber on state lands. HB 50 was expected to result in additional sales of timber during the 1997 biennium. However, additional costs associated with the sale of timber were also expected to be incurred. These costs were deducted from timber sale revenues.

HB 201, passed by the 1995 legislature, required the state to increase timber sales from state lands consistent with an annual sustainable yield of 45 million board feet to 55 million board feet, contingent on a study to determine the appropriate level of annual sustainable yield. HB 201 capped the amount of timber sale revenue deposited in the general fund (formerly the school equalization account, which was abolished in SB 83) from the common school trust at an average annual sale value of 18 million board feet. Any excess timber sale revenue from the common school trust was to be deposited in the general fund, but "earmarked" for deposit in the school districts' newly established technology acquisition fund, to buy technological equipment and provide technical training for school district personnel.

HB 201 also affected timber sale revenue because it diverted timber sale revenue before it was deposited in the general fund to pay for costs associated with increasing timber sales. The total revenue effect was estimated to be a loss of \$1.1 million to the general fund during the 1997 biennium.

HB 274, passed by the 1995 legislature, granted the Department of State Lands broader discretion to expedite sales of state timber in emergency situations and limited access situations. Effective in FY 1996, as a result of the natural resources reorganization bill (SB 234), the forestry function was transferred from the Department of State Lands to the Department of Natural Resources and Conservation.

SB 83 de-earmarked all interest from the common school trust and income earned on common school lands. Henceforth, these revenues flow into the general fund.

1997 Legislative Action

The 1997 legislature passed legislation that impacted the flow of timber revenue into the common school trust by appropriating timber revenue for use by the DNRC to enhance timber sales during the 1999 biennium. The amounts appropriated, \$1.2 million and \$1.3 million in respective years of the biennium, were diverted from the revenue stream before the allocation of 5 percent of revenue to the trust.

HB 2 appropriated anticipated timber sale revenue in excess of that associated with 18 million board feet for deposition in schools' technology acquisition funds. The purpose of the fund is to allow each district to buy technological equipment and provide technical training for school district personnel. The amounts appropriated were \$1.5 million in FY 1998 and \$2.8 million in FY 1999, or the amount of "excess" revenue in each year, whichever is less.

1999 Legislative Action

SB 48 made significant changes in funding the Trust Land Management Division in the Department of Natural Resources and Conservation. The legislation diverted a portion of the following money (previously deposited into the corpus of the land trust funds) from certain land trusts administered by the department: 1) mineral royalties; 2) the proceeds or income from the sale of easements and timber (except timber from public school lands); and 3) 5 percent of the interest and income previously credited annually to the public school fund. The money was diverted to a state special revenue account to pay costs of administering state trust lands. The legislation provided limitations on the amount of diverted revenue and the amount of the appropriations: 1) the diverted revenue was limited to 1-1/8 percent of the book value balance in each of the nine nonexpendable trust funds on the first day of January preceding the new biennium and 10 percent of the previous fiscal year revenue deposited into the capitol building land grant trust fund; and 2) appropriations of the money were limited to 1-1/8 percent of the book value balance in the nine nonexpendable trust funds on the first day of January preceding the new biennium and 10 percent of the revenue deposited in the capitol building land grant trust fund in the last completed fiscal year prior to the new biennium. In HB 2, the legislature replaced \$7.1 million of general fund appropriations with state special revenue provided by this legislation. Therefore, deposits to land trusts (primarily the Common School Trust) were reduced by \$7.1 million over the biennium, approximately \$3.5 million per year.

2001 Legislative Action

Although SB 495 potentially could have increase the balance of the common school trust by \$75 million due to the sale of its mineral production rights, the increase depended on the amount of rights purchased by DNRC and the sale price. The actual purchase price of the mineral production rights was \$46.4 million and this amount was deposited to the trust. Since future royalties from any sold mineral production rights are no longer deposited in the common school trust, the future growth of the trust is substantially curtailed. For further information and analysis of SB 495, contact the Legislative Fiscal Division for a copy of the two-part report: "SB 495 – Implementation, Impacts and Implications".

Resource Indemnity Trust

Article IX, Section 2 of the Montana Constitution and Title 35, Chapter 38, MCA, require that certain resource extraction taxes be placed in a trust. The principal of the resource indemnity trust "shall forever remain inviolate in an amount of one hundred million dollars (\$100,000,000), guaranteed by the state against loss or diversion." Once the principal of the trust reaches \$100 million, any additional tax revenue may be appropriated.

During the July 1992 special session, the legislature imposed a one-year surtax on resource indemnity tax liabilities and allocated collections from the surtax to the general fund. During the 1993 legislative session, the legislature passed HB 608 that decreased the amount of resource indemnity and groundwater assessment (RIGWA) tax proceeds deposited in the trust during the 1995 biennium from 85.9 percent per year to 55.9 percent, or approximately \$5.0 million. The bill further reduced the amount of RIGWA tax revenue deposited in the trust to 45.9 percent beginning July 1, 1995. During the 1995 session, the legislature replaced a portion of RIGWA tax proceeds with oil and gas tax proceeds due to a bill to simplify oil and gas taxes (SB 412). Also, the legislature diverted for other purposes the metal mines license tax proceeds that previously were deposited to the trust.

1997 Legislative Action

SB 377 reduced the growth rate in the ending fund balance of the RIT trust by diverting \$200,000 per year from RIGWA tax inflows and 8.5 percent from metalliferous mines license tax revenue to a newly created orphan share account. The reduction of inflow into the trust in each year of the biennium as a result of these diversions was \$674,000 and \$743,000. The orphan share account is used to: 1) fund remedial actions on the portion of hazardous waste sites for which there is no responsible party; and 2) pay for DEQ transaction costs associated with defending the orphan share proportions.

1999 Legislative Action

SB 49 and SB 492 increased the allocation of the RIGWA tax and the RIT share of the oil and gas production tax to the RIT. The ending fund balance at the end of the 2001 biennium was estimated to increase by \$162,000 as a result of the legislation. The legislation also eliminated the allocation of RIGWA tax revenue to the RIT beginning July 1 of the first year following the date that the governor by executive order certified to the secretary of state that the RIT balance has reached \$100 million.

2001 Legislative Action

The RIT balance reached the \$100 million amount in FY 2002 and the balance was certified by the governor. Therefore, no additional revenue is deposited in the trust beginning FY 2003. The revenue estimates showed that there would be an estimated \$101.1 million in the trust balance by the end of FY 2003. Since any additional tax deposits over the \$100 million may be appropriated by the legislature, the 2001 legislature enacted the following legislation that uses all of the excess revenue: 1) SB 326 authorized the transfer of \$500,000 to the noxious weed state special revenue account for distribution to counties (the money is appropriated in HB 2); 2) HB 2 transferred and appropriated \$540,000 to purchase securities for water treatment at the former Zortman and Landusky mines; and 3) HB 2 transferred and appropriated \$120,000 for the Clark Fork River task force (established in HB 397).

Tobacco Settlement Trust

Montana receives revenue as a settling party to master settlement agreement with four original tobacco companies and 43 subsequent companies that ended a four-year legal battle that included 46 states, and six other entities. Montana is eligible for four types of payment: 1) reimbursement for legal costs (received December 1999); 2) five initial payments (two in FY 2000 with an additional one per year in FY 2001, 2002, and 2003); 3) on-going annual payments; and 4) strategic contribution payments (from FY 2008 through 2017). The master settlement agreement places no restrictions on how states are to spend the money. Contrary to popular belief, the payments will be received in perpetuity.

The total amount of tobacco settlement funds available to Montana may be affected by a number of adjustments. The three most important are the adjustments for inflation, volume of cigarettes shipped nationally, and loss of market shares for participating manufacturers. The amount of Montana's annual share will increase by a minimum amount of 3 percent or more if inflation is greater than 3 percent. The amount will decrease if the number of cigarettes shipped nationally decreases and will increase if the number increases. If it is verified that participating manufacturers have lost market shares due to disadvantages caused by the settlement, distributions will decrease.

2000 Constitutional Amendment

Due to passage of Montana Constitutional Amendment 35 in November 2000, the legislature is required to dedicate not less than 40 percent of the tobacco settlement money to a permanent trust fund. The remainder of the money is deposited into the general fund. Since the legislature did not pass legislation establishing the exact percentage to be deposited to the trust fund, the revenue estimate assumes 40 percent. Interest earnings from the trust fund are to be distributed: 1) 90 percent for appropriation by the legislature for tobacco related disease prevention programs and state programs providing benefits, services, or coverage that are related to the health care needs of the people of Montana; and 2) 10 percent to the trust. Money in the trust fund can be spent if approved by two-thirds of each house of the legislature. Appropriations of principal, income, or interest from the trust fund cannot be used to replace state or federal money used to fund tobacco disease prevention programs that existed on December 31, 1999.

2001 Legislative Action

The 2001 legislature enacted SB 129 that established a Montana tobacco settlement non-expendable trust fund to implement Article XII, Section 4, of the Montana Constitution. The legislation also provided criteria to govern the purposes for which the interest, income, and principal of the trust may be appropriated. It did not establish a statutory percentage of the tobacco settlement dedicated for deposit in the trust fund.

2002 Initiative

Due to passage of Initiative 146 by the electorate in November 2002, beginning in FY 2004, 32 percent of the total tobacco settlement money funds tobacco prevention programs and 17 percent funds the Children's Health Insurance Program. The remaining 11 percent of the total settlement money is deposited to the general fund.

2003 Legislative Action

The 2003 legislature enacted SB 485 that changed Initiative 146 by increasing the programs that can be funded by tobacco settlement money, but only through FY 2005. With the changes, the 32 percent allocation can be used for human services programs and the 17 percent allocation can be used to match federal Medicaid money. The legislation also transferred \$5,831,360 in FY 2004 and \$6,057,600 in FY 2005 from the account receiving the 32 percent allocation to a newly created prevention and stabilization state special revenue account. Money in this account is used by the Department of Public Health and Human Services to finance, administer, and provide health and human services.

Noxious Weed Management Trust

During the period FY 1986 through 1992, at least one-half of the collections from a 1 percent surcharge on the retail sale of herbicides was deposited in the noxious weed management trust fund. The remaining collections were spent for weed control grants. The interest earned on the trust is retained in the trust. After the principal of the trust reached \$2.5 million in FY 1992, all herbicide surcharge collections and the interest earned on the trust became available for weed control grants.

1995 Legislative Action

SB 321, passed by the 1995 Legislature, increased the amount of the gasoline tax revenue allocated to the snowmobile account from 23/64 of one percent to 15/28 of one percent. Beginning in FY 1996, one percent of the amount deposited in the snowmobile account is deposited in the Montana noxious weed control trust administered by the Department of Agriculture.

1999 Legislative Action

For the 2001 biennium, SB 164 transferred \$1.1 million per year to the noxious weed trust from the highway non-restricted account in 15-70-125, MCA. As a result, the ending fund balance in the trust will almost double by June 30, 2002.

2001 Legislative Action

The August 2002 special legislative session reduced the transfer to the noxious weed state special revenue account for counties to \$300,000.

2004 Constitutional Amendment

The electorate in the November 2004 election approved an amendment to the Montana Constitution (C-40) creating a noxious weed management trust fund. Ten million dollars of the principal of the fund is to remain forever inviolate unless appropriated by three-fourths of each house of the legislature. Appropriations of the principal over \$10 million and the interest and income can only be used to fund the noxious weed management program, as provided by law.

STATUTORY TRUSTS***Education Trust***

From FY 1976 through 1986, a portion of the revenue from the coal severance tax was allocated to an education trust for the support of education. The legislature appropriated the corpus of this trust to the school equalization account during the period of FY 1987 through 1990. Since FY 1990, the education trust has not received revenue from any source and its balance is zero.

Parks Acquisition Trust/Cultural Protection Trust

During most of the years since 1979, a portion of the coal severance tax has been earmarked for the parks acquisition trust. During the late 1980s, the flow of revenue into this account was diverted to the general fund. However, the principal began to increase again in FY 1990. Prior to FY 1992, two-thirds of the interest from this trust was statutorily allocated for acquisition and operation of state parks, and one-third was allocated for protection of works of art in the state capitol, and other cultural and aesthetics projects.

The 1991 legislature split the principal of this trust into two separate trusts, a parks acquisition trust and an arts protection trust. During the 1993 biennium, the coal tax revenue that would have flowed into the parks acquisition trust (1.267 percent) was spent for maintenance of parks and historic sites, along with the interest from the trust. HB 687, passed during the 1993 legislative session, continued this practice for the 1995 biennium, allocating \$1.6 million from the trust to current operations. In the 1997 biennium, the coal tax revenue allocation was again deposited in the trust. SB 27, passed by the 1995 legislature, increased the allocation to the parks acquisition trust from 1.267 percent to 1.270 percent.

In FY 1992, 0.633 percent of coal severance tax revenues were deposited in the arts protection trust, with the trust interest continuing to be used for protection of works of art and for cultural and aesthetics projects. During the January 1992 special session, the legislature diverted a portion of the revenue that would have flowed into the arts protection trust in FY 1993 to fund the operations of the Montana Arts Council. Beginning in FY 1994, these revenues were again deposited in the trust. SB 27, passed by the 1995 legislature, decreased the allocation to the arts trust from 0.633 percent to 0.63 percent.

1997 Legislative Action

The 1997 legislature amended the allocation of coal severance taxes under 15-35-108, MCA. HB 5 eliminated the 0.63 percent distribution of coal severance tax to the cultural and aesthetic trust during the 1999 biennium only. The legislature appropriated \$3.9 million from the cultural trust for the immediate purchase of the Virginia City and Nevada City properties. This appropriation resulted in a loss of trust interest revenue that otherwise would be used to fund C&A projects in the state during the 1999 biennium. In order to compensate for the lost interest, the legislature allocated 0.87 percent of coal severance tax revenue to the C&A projects account, and eliminated the 0.63 percent of coal severance tax revenue that had been deposited in the cultural trust. The remaining 0.24 percent of coal taxes allocated to the C&A project account was previously part of the flow into the general fund. After the 1999 biennium, similar amounts of coal severance tax revenue were diverted from the C&A projects account and again flowed to the general fund.

1999 Legislative Action

HB 260, HB 69, and SB 220 reduced coal severance tax revenue and replaced it with coal license tax revenue. The aim of the legislation was to hold the revenue flow into the arts and parks trusts as under current law. However, the arts and parks trusts lost around \$25,000 over the biennium.

The January 20, 2000 decision of the Montana Supreme Court that found HB 260 violated Article IX, Section 5, of the Montana Constitution rendered the above changes meaningless.

2001 Legislative Action

In the August 2002 special legislative session, for FY 2003, the legislature temporarily diverted the parks acquisition trust, 1.27 percent allocation and the cultural trust, 0.63 percent allocation to the general fund. Beginning in FY 2004, the allocations resume.

GLOSSARY / INDEX



Glossary

A number of terms are used extensively in budgeting and appropriations. The most common terms, which are used throughout the budget analysis and in other fiscal materials, are listed and defined below.

Appropriations – An authorization by law for the expenditure of funds or to acquire obligations. Types of appropriations are listed below.

Biennial – A biennial appropriation is an appropriation made in the first year of the biennium, where the appropriated amount can be spent in either year of the biennium.

Budget amendment – See “Budget Amendment” below.

Continuing – An appropriation that continues beyond one biennium.

Language – An appropriation made in the language of the general appropriations act for a non-specific or limited dollar amount. Language appropriations are generally used when an agency knows that it will be receiving federal or state special revenue funds but is uncertain as to the amount.

Line Item – An appropriation made for a specific purpose and which cannot be used for any other purpose. Line item appropriations highlight certain appropriations and ensure that they can be separately tracked on the state accounting system.

One-time – Appropriations for a one-time purpose that are excluded from the base budget in the next biennium.

Restricted – An appropriation designated for a specific purpose or function.

Statutory – Funds appropriated in permanent law rather than a temporary bill. All statutory appropriations references are listed in 17-7-502, MCA.

Temporary - An appropriation authorized by the legislature in the general appropriations act or in a “cat and dog” bill that is valid only for the biennium.

Appropriation Transfers (also see “Supplemental Appropriation”) – The transfer of funds appropriated for the second year of the biennium to the first if the Governor or other approving authority determines that due to an unforeseen or unanticipated emergency there are insufficient funds in the first year for the operation of an agency.

Approving Authority – The entity designated in law as having the authority to approve certain budgetary changes during the interim. The approving authorities are:

- the Governor or his/her designated representative for executive branch agencies
- the Chief Justice of the Supreme Court or his/her designated representative for the judicial branch agencies
- the Speaker of the House of Representatives for the House;
- the President of the Senate for the Senate

- the appropriate standing legislative committees or designated representative for the legislative branch divisions; and
- the Board of Regents of Higher Education or their designated representative for the university system.

Average Daily Population (ADP) – The population measure used to calculate population in the Montana correctional system. ADP is equivalent to one inmate incarcerated for one year.

Average Number Belonging (ANB) – The enrollment measure used for K-12 BASE aid calculations. ANB is the equivalent of one full-time student enrolled in school for the full school year.

Base – The level of funding authorized by the previous legislature.

Base Budget – The resources needed for the operation of state government that provide for expenses of an ongoing and non-extraordinary nature in the current biennium.

Benefits – An expenditure category used to account for the provision of payments or services by the government to individuals who qualify for receipt of those payments or services, such as Medicaid benefits. Personal services benefits for state employees are included in the personal services expenditure category.

Biennial Appropriation – An appropriation that can be expended in either or both years of the biennium.

Biennium – A two-year period. For the state, this period begins July 1 of the odd-numbered years and ends June 30 of the following odd-numbered year.

Budget Amendments – Temporary authority to spend unanticipated non-general fund revenue received after the legislature adjourns. The funds must be used to provide additional services and cannot make a commitment of general fund support for the present or future.

Cat and Dog Appropriations – One-time appropriations made in bills other than the general appropriations act.

Debt Service – The payment on outstanding bonds.

Decision Package – Separate, specific adjustments to the base budget. Decision packages can be either present law adjustments or new proposals.

Earmarked Revenue – Funds from a specific source that can be spent only for designated activities.

Enterprise Funds – A fund used to account for operations financed and operated similar to private business enterprises, where the intent of the legislature is to finance or recover costs, primarily through user charges.

Federal Special Revenue – Accounts deposited in the state treasury from federal sources, to be used for the operation of state government.

Fiduciary Funds – Funds used to account for assets held by the state in a trustee capacity or as an agent for individuals, private organizations, other governments, or other funds.

Fiscal Note - An estimate, prepared by the Office of Budget and Program Planning, of the probable revenues and costs that will be incurred as the result of a bill or joint resolution.

Fiscal Year (FY) aka State Fiscal Year (SFY) – A 12-month accounting period beginning July 1 and ending June 30. Fiscal year 2003 refers to the fiscal year ending June 30, 2003. (Note: The federal fiscal year (FFY) is October 1 through September 30.)

Fixed Costs – Fees (fixed costs) charged to agencies for a variety of services provided by other state agencies (e.g., payroll service fees, rent, warrant writing services, and data network services.).

FTE – Full-Time Equivalent position, or the equivalent of one person working full-time for the entire year. Also used to denote full-time equivalent students in the Montana University System for purposes of calculating state support.

Fund – A fiscal entity with revenues and expenses which are segregated for the purpose of carrying out a specific purpose or activity.

General Fund – Accounts for all governmental financial resources except those that must be accounted for in another fund.

General Fund Reversions – Unspent appropriated funds that are returned to the general fund at the close of the budget period.

Grants – An expenditure category used to account for the payment by a government entity to an individual or other entity who will perform a service.

HB 2 –The General Appropriations Act in which the legislature authorizes the funding for state government for the upcoming biennium. Each session, House Bill 2 is reserved for this purpose.

Indirect Cost – A cost necessary for the functioning of the organization as a whole, but which cannot be directly assigned to a specific division or agency.

Interim – The time between regular legislative sessions.

Internal Service Funds – Funds use to account for the financing of goods and services provided by one department or agency to other departments, agencies, or governmental entities on a cost-reimbursement basis.

IRIS - The Integrated Revenue Information System (IRIS) is an automated system to administer taxes that are the responsibility of the Department of Revenue to collect.

Local Assistance – An expenditure classification primarily used to account for expenditures made for K-12 funding provided by the state to school districts.

MBARS – The Montana Budget Analysis and Reporting System, which provides all state agencies with one computerized system for budget development, maintenance and tracking, and is integrated with the State Accounting, Budget, and Human Resource System (SABHRS).

Mill – The property tax rate based on the valuation of property. A tax rate of one mill produces one dollar of taxes on each \$1,000 of assessed property value.

New Proposals – Requests (decision packages) to provide new non-mandated services, to change program services, to eliminate existing services, or to change the source of funds.

Non-budgeted Expenditures – Accounting entries for depreciation, amortization, and other financial transactions that appear as expenditures, but don't actually result in direct dispersal of funds from the state treasury.

Operating Expenses – All operating expenditures that do not meet the personal services and capital outlay classification criteria. These expenditures include, but are not limited to, professional services, supplies, rent, travel, and repair and maintenance.

Other Funds – Capital projects and fiduciary funds.

Capital projects fund – Accounts for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds.

Fiduciary funds – Trust and agency fund types used to account for assets held by state government in a trustee capacity or as an agency for individuals, private organizations, other governmental entities, or other funds.

Pay Plan – Provision by the legislature of a general adjustment to salaries and/or benefits paid to state employees. Also refers to the pay schedule listing the state salary rate for each classified position according to that position's grade and the market rate.

Personal Services – Expenditures for salaries, benefits, per diem, and other additions, such as overtime.

Personal Services Snapshot – The point in time at which personal services attributes are captured and from which the personal services budget is determined. The executive budget personal services costs are based on a "snapshot" of actual salaries for authorized FTE as they existed in a pre-determined pay period in the base year.

Present Law – The additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature.

Present Law Adjustments – Requests (decision packages) for an adjustment in funding sufficient to allow maintenance of operations and services at the level authorized by the previous legislature (e.g., caseload, enrollment changes, and legally mandated workload).

Program – A group of related activities performed by one or more organizational units for the purpose of accomplishing a function for which the government is responsible. Also, a grouping of functions or

objectives that provides the basis for legislative review of agency activities for appropriations and accountability purposes.

Proprietary Funds – Enterprise or internal service funds. Statute does not require that most proprietary funds be appropriated.

Enterprise funds – Funds that account for operations financed and operated in a manner similar to private business enterprises, and through which the intent is to provide goods or services to the public.

Internal service funds- Funds that account for the financing of goods or services provided by one department or agency to other departments or agencies of state government.

Reporting Levels – Budget units dividing agency and program budgets into smaller units for the purpose of constructing, analyzing, and approving budgets.

SABHRS – The State Accounting, Budget, and Human Resource System that combines the state's accounting, budgeting, personnel, payroll, and asset management systems into one single system.

State Special Revenue – Accounts for money from state and other nonfederal sources that is earmarked for a particular purpose, as well as money from other non-state or nonfederal sources that is restricted by law or by the terms of an agreement.

Supplemental Appropriation – An additional appropriation made by the governing body after the budget year or biennium has started. There are two types of supplemental appropriations that can be used to increase spending authority for a fiscal year: 1) a transaction in an even-numbered year that moves spending authority from the second year of the biennium to the first year; or 2) an appropriation passed and approved by the legislature to provide authority for the odd-numbered fiscal year ending the current biennium.

Vacancy Savings – The difference between what agencies actually spend for personal services and the cost of fully funding all funded positions for the entire year.

Acronyms

Acronyms are used to denote agencies, programs, and common terms. The following list includes some of the most common.

AES – Agricultural Experiment Station(s)
ADP – Average Daily Population (institutions)
ANB – Average Number Belonging (K-12 education)
ARM – Administrative Rules of Montana
BASE Aid – Base Amount for School Equity Aid
BPE - Board of Public Education
C&A – Cultural and Aesthetic (Trust)
CC - Community Colleges
CES - Cooperative Extension Service
CHE - Commissioner of Higher Education
CHIP – Children’s Health Insurance Program (also SCHIP)
CIO – Chief Information Officer
COPP - Commissioner of Political Practices
COT - College of Technology, followed by campus designation
CPI – Consumer Price Index
DEQ – Department of Environmental Quality
DMA – Department of Military Affairs
DNRC – Department of Natural Resources and Conservation
DOA – Department of Administration
DOA – Department of Agriculture
DOC –Department of Commerce (see Corrections)
DOC – Department of Corrections (see Commerce)
DOJ – Department of Justice
DOLI – Department of Labor and Industry
DOR – Department of Revenue
DP – Decision Package
DPHHS – Department of Public Health and Human Services
FCES - Forestry and Conservation Experiment Station
FMAP – Federal Medical Assistance Participation rate (Medicaid)
FSR – Federal Special Revenue
FSTS - Fire Services Training School
FTE – Full-Time Equivalent
FWP – Department of Fish, Wildlife, and Parks
FFY – Federal Fiscal Year
FY – Fiscal Year
FYE - Fiscal Year End
GAAP – Generally Accepted Accounting Principles
GF – General Fund
GSL – Guaranteed Student Loan
GTB – Guaranteed Tax Base
HAC – House Appropriations Committee
HSRA – Highways Special Revenue Account

I&I – Interest and Income
IRIS – Integrated Revenue Information System
IT – Information Technology
ITSD - Information Technology Services Division
LAD - Legislative Audit Division
LEPO - Legislative Environmental Policy Office
LFA – Legislative Fiscal Analyst
LFC – Legislative Finance Committee
LFD - Legislative Fiscal Division
LRBP - Long Range Building Program
LRP – Long Range Planning
LSD - Legislative Services Division
MAC - Montana Arts Council
MBARS – Montana Budgeting, Analysis, and Reporting System
MBCC – Montana Board of Crime Control
MBMG – Montana Bureau of Mines and Geology
MCA – Montana Code Annotated
MCHA – Montana Comprehensive Health Association
MDT – Montana Department of Transportation
MHP - Montana Highway Patrol
MHS - Montana Historical Society
MSDB – Montana School for the Deaf and Blind
MSF – Montana State Fund
MSL - Montana State Library
MSU - Montana State University, followed by campus designation i.e. MSU – Bozeman
MUS - Montana University System
NP – New Proposal
OBPP - Office of Budget and Program Planning
OCHE – Office of the Commissioner of Higher Education
OPI - Office of Public Instruction
PERS - Public Employees Retirement System
PL – Present Law
POINTS – Process Oriented Integrated Tax System
PSC - Public Service Commission
RIGWA – Resource Indemnity and Groundwater Assessment Tax
RIT – Resource Indemnity Trust
SABHRS – Statewide Accounting, Budgeting, and Human Resources System
SAO - State Auditor's Office
SF&C –Senate Finance and Claims Committee
SOS - Secretary of State
SSR - State Special Revenue
TANF - Temporary Assistance for Needy Families
TEA – 21 – Transportation Equity Act for the 21st Century
TRS – Teachers' Retirement System
TSEP - Treasure State Endowment Program
UM - University of Montana, followed by campus designation i.e. UM – Missoula

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